

[COMMITTEE PRINT]

PROPOSED INCOME TAX TREATY
BETWEEN THE UNITED STATES
AND THE PHILIPPINES

PREPARED FOR THE USE OF THE
COMMITTEE ON FOREIGN RELATIONS
BY THE STAFF OF THE
JOINT COMMITTEE ON TAXATION



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INTRODUCTION

This pamphlet describes the proposed income tax treaty between the United States and the Republic of the Philippines. The purpose of the proposed treaty is to reduce any double taxation on income earned within one country by residents of the other country and to provide various administrative procedures to aid in resolving interpretative disputes and in enforcing the taxes of both countries. The proposed treaty was signed on October 1, 1976, and was modified by an exchange of notes dated November 24, 1976. No similar treaty between the two countries is in force at the present time.

The proposed treaty is similar to recent U.S. income tax treaties and to the model tax treaty of the Organization of Economic Cooperation and Development (OECD) in virtually all respects. However, a few provisions, deserve special comment.

(1) The proposed treaty departs from prior U.S. treaties and does not provide for a reciprocal exemption of income from the operation of ships or aircraft in international traffic. Under the treaty, both countries may tax income from the operation of aircraft in international traffic in accordance with their own domestic laws. In the case of income from the operation of ships in international traffic the tax imposed by either country is not to exceed 1.5 percent of the gross revenues derived from outgoing traffic originating in that country. Under this provision (article 9) U.S. residents operating ships or aircraft in international traffic may be subject to more burdensome transaction in the Philippines than Philippine corporations, which under normal treaty rules would violate the provisions against discrimination. However, the treaty specifically excepts this provision from the discrimination provisions (article 24).

(2) The treaty provides that the United States will limit its withholding tax on royalty income to 15 percent. However, the Philippine withholding tax is to be 25 percent, with exceptions for royalties paid with respect to investments under Philippine incentive programs, which are subject to a 15 percent withholding tax, an exception is also provided in any case where the Philippines agree by treaty with a third country to a lower withholding tax on any type of royalty income.

(3) The treaty provides that each country may impose a withholding tax of up to 25 percent on dividends paid to portfolio investors of the other country; a withholding tax of up to 20 percent is permitted on dividends paid to direct investors.

(4) The withholding tax on interest is generally limited to 15 percent with respect to interest paid to resident of either country. However, interest derived from public issues of bonded indebtedness may not be subject to withholding in excess of 10 percent.

(5) The proposed treaty contains a nondiscrimination provision (article 24) which applies to all taxes of every kind proposed at the national, State or local levels of either country. The provision generally follows the nondiscrimination provisions in other U.S. tax treaties. However, the proposed treaty does allow the Philippines to provide solely for Philippine nationals the incentives granted under specific provisions of existing law. These exemptions permit: (a) A deduction for certain amounts invested in new shares of pioneer industries and a shorter holding period to qualify for capital gains treatment on the sale of such shares; (ii) a deduction for certain local costs of export production to firms which are 60 percent Philippine owned; and (iii) limited incentives to investments in tourist facilities.

(6) The proposed treaty contains a relief from double taxation provision (article 23) similar to those contained in other U.S. treaties under which each country agrees to allow its citizens and residents a credit for taxes paid to the other country. However, the exchange of notes modifying article 23(2) allows the Philippines to provide a deduction for U.S. taxes paid by Philippine citizens abroad, rather than a foreign tax credit, so long as the present relatively low rates of Philippine tax (up to 3 percent) currently in effect with respect to such income remain unchanged.

(7) The proposed treaty provides that income derived by residents of one country from performing personal services as an employee in the other country is exempt from tax in that other country unless the individual remains there for 90 days or longer during the year (article 16) or, in the case of services performed in an independent capacity (article 15), if the gross remuneration exceeds \$10,000 (or a higher amount agreed to by the tax authorities of the two countries). The 90-day period is consistent with the U.S. statutory rule concerning employees of foreign companies in the United States but is shorter than the 183-day period ordinarily provided for in U.S. tax treaties and the OECD model tax treaty. The proposed treaty contains a separate provision which provides for the exemption of public entertainers and athletes (article 17) performing services in the other country where the income does not exceed the lesser of \$100 per day or \$3,000 per year.

General Explanation

Article 1. Taxes covered

The proposed treaty applies to the U.S. Federal income taxes imposed under the Internal Revenue Code (other than the tax on accumulated earnings or the personal holdings company tax). It likewise applies to the income tax imposed by Title II of the National Internal Revenue Code of the Philippines, but not including the tax on improperly accumulated earnings or the personal holding company tax. The proposed treaty also contains a provision generally found in U.S. income tax treaties which applies the treaty to substantially similar taxes which either country may subsequently impose.

Article 2. General definitions

† The standard definitions found in most of our income tax treaties are contained in the proposed treaty. The definition of the term "United States," is interpreted by the Treasury Department to incorporate the territorial sea of the United States and the continental shelf of the United States insofar as the exploration and exploitation of natural resources on the continental shelf is concerned. The definition of the Philippines is interpreted in the same manner.

The proposed treaty also contains the standard provision that undefined terms are to have the meaning which they have under the applicable tax laws of the country applying the treaty. Where a term is defined in a different manner by the two countries or where its meaning under the laws of either country is not readily determinable, the competent authorities of the two countries may establish a common meaning for the term in order to prevent double taxation or to further any other purpose of the treaty.

Article 3. Fiscal residence

The benefits of the proposed treaty generally are available only to residents of the two countries. The proposed treaty defines "resident of the Philippines" and "resident of the United States," and in addition provides a set of rules to determine residence in the case of an individual with dual residence. This provision of the proposed treaty is based on the fiscal domicile article of the OCED model treaty and is similar to the provisions found in other U.S. tax treaties.

An individual whom both countries consider to be a resident according to their general rules for determining resident will be deemed for all purposes of the treaty to be a resident of the country in which he has his permanent home (where an individual dwells with his family), his center of vital interests (his closest economic and personal relations), his habitual abode, or his citizenship. If the residence of an individual cannot be determined by these tests, applied in the order stated, the competent authorities of the countries will settle the question by mutual agreement.

Article 4. Source of income

The source of income rules establish the framework for the basic provision in the treaty (Article 6) that one country may tax residents and corporations of the other country only on income from sources within the taxing country (provided, with certain exceptions, that the resident is not a citizen of the taxing country). The rules are also important because the U.S. foreign tax credit is limited to the U.S. tax on income from sources outside the United States. Several of the source rules contained in the proposed treaty differ in some degree from the source rules provided in the Internal Revenue Code. However, since the general rules of taxation contained in the proposed treaty (Article 6) provide that the treaty will not be applied increase a person's tax, a taxpayer is not bound to apply the rules described below where the treaty rules would increase his U.S. tax liability.

The proposed treaty provides that dividends will be treated as income from sources within a country if paid by a corporation of that country. However, dividends paid by a corporation of any country are to be treated as income from sources within one country if for the prior three years at least 50 percent of that corporation's gross income constituted industrial or commercial profits attributable to a permanent establishment in that country. However, the dividend will be treated as from sources within the country of the permanent establishment only in proportion to the corporation's gross income from the permanent establishment.

Under the proposed treaty, interest will be treated as income from sources within a country only if paid by that country, a political subdivision or a local authority thereof, or by a resident of that country. However, interest paid on an indebtedness incurred in connection with a permanent establishment will be sourced in the country where the permanent establishment is situated. This exception permits one country, under the proper circumstances, to tax interest paid by a permanent establishment maintained in that country by a resident of the other country or by a resident of a third country.

In addition, the source rule for interest paid by permanent establishments will operate to exempt interest from tax in the country of the taxpayer's residence if the interest is paid to a resident of the other country by a permanent establishment situated in a third country (and the indebtedness was incurred in connection with the third country permanent establishment). This results from the restriction in Article 6 (General rules of taxation) that a resident of one country who is not a citizen of the other country may be taxed by the other country only on income from sources within that other country.

The proposed treaty provides that royalties for the use of, or the right to use, property or rights will be treated as income from sources within a country only to the extent that such royalties are for the use of, or the right to use, the property or rights within that country. However, an exception is also provided under which royalties are allocated to the country in which a permanent establishment is situated if the royalty is incurred in connection with the permanent establishment.

Income (including mineral royalties) to which the provision relating to income from real property (Article 7) applies will be treated as income from sources within a country only if the real property (or, in

the case of a mineral royalty, the underlying real property) is situated in that country.

Income received by an individual for his performance of labor or personal services, whether as an employee or in an independent capacity, will be treated as income from sources within a country only to the extent that such services are performed in that country. Income from personal services performed aboard ships or aircraft operated by a resident of one country in international traffic will be treated as income from sources within that country if performed by a member of the regular complement of the ship or aircraft. However, compensation described in Article 20 (Governmental functions) and social security payments (Article 19) will be treated as income from sources within the country making the payments.

The treaty contains a rule not provided in other U.S. treaties that income from the operation of ships in international traffic is to be treated as from sources within the country from which the ship's travel originated. This new source rule becomes significant with the provisions of Article 9 and is discussed in some detail in conjunction with those provisions.

Industrial or commercial profits attributable to a permanent establishment will be considered to be from sources within the country in which the permanent establishment is located. This rule also applies to passive income of the types described above (interest, royalties, etc.) in situations where the passive income is treated as industrial or commercial profits because it is effectively connected with the permanent establishment.

The source of any item of income not specified in this article will be determined by each country in accordance with its own law. However, if the source of any item of income under the laws of one country is different from its source under the laws of the other country, or if its source is not readily determinable under the laws of either, the competent authorities of the two countries may, in order to prevent double taxation or further any other purpose of the proposed treaty, establish a common source of the item of income for purposes of the proposed treaty.

Article 5. Permanent establishment

The proposed treaty contains a definition of permanent establishment which generally follows the pattern of the OECD model tax treaty and other recent U.S. income tax treaties. The permanent establishment concept is one of the basic devices used in income tax treaties to avoid double taxation. Generally, a resident of one country is not taxable on its business profits by the other country 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 are applicable.

In general, a fixed place of business through which a resident of one country engages in industrial or commercial activities in the other country is considered a permanent establishment. The treaty specifies that a fixed place of business includes a seat of management; a branch; an office; a store or other sales outlet; a factory; a workshop; a warehouse; a mine quarry, or other place of extraction of other natural

resources; and any building site or construction or assembly project (or supervision activity connected therewith and conducted within the country where a site or project is located) which was maintained for more than 183 days; and the furnishing of services, including consulting services, by a resident of one country through employees or other personnel where the activities making up the services continue within the other country for over 183 days.

This general rule is modified to provide that a fixed place of business which is used for any of a number of specified activities will not constitute a permanent establishment. These activities include the use of facilities for storing, displaying, or delivering merchandise belonging to the resident; the maintenance of a stock of goods belonging to the resident for purposes of storage, display, delivery, or processing by another person; the purchase of goods, collection of information, advertising, scientific research, or other auxiliary activities, for the resident; and the furnishing of services in accordance with an agreement between the countries regarding technical cooperation (such as the Economic and Technical Cooperation Agreement of April 27, 1951).

A resident shall not be deemed to have a permanent establishment in the other country merely because the resident sells goods which were displayed at trade fairs or conventions in that other country. The trade fair exception is not intended to apply with respect to goods in the resident's inventory.

A resident of one country who collects premiums in the other country or insures risks located there is to be treated as having a permanent establishment in the other country, except with respect to reinsurance.

A resident of one country will be deemed to have a permanent establishment in the other country if it maintains an agent in the other country who has, and habitually exercises, a general contracting authority (other than for the purchase of merchandise) in that other country. The proposed treaty contains the usual provision that the agency rule will not apply if the agent is a broker, general commission agent or other agent of independent status acting in the ordinary course of its business.

The determination of whether a resident of one country has a permanent establishment in the other country is to be made without regard to the fact that the resident may be related to a resident of the other country or to a person who engages in business to that other country.

Article 6. General rules of taxation

The proposed treaty contains the basic general rules of taxation which are found in most of our other tax treaties. A resident of one country may be taxed by the other country only on income from sources within that other country (which includes business profits only to the extent they are attributable to a permanent establishment in that other country). For this purpose, the source rules of Article 4 are to be applied. The proposed treaty also contains the customary rule (the "saving clause") that it may not be applied to increase the tax burden of either country beyond what it would be in the absence of the treaty—that is, the treaty only applies in those situations where it benefits taxpayers.

Additionally, the proposed treaty provides that, with certain exceptions, the treaty is not to affect the taxation by the United States or the Philippines of their citizens or residents. However, this saving clause does not apply in several cases where its application would nullify specific policies contained in the proposed treaty which are designed to benefit residents and citizens. The principal exceptions involve social security payments, the foreign tax credit, and nondiscrimination. The saving clause also does not affect the benefits provided to resident aliens under the provisions relating to diplomatic or consular officers or other governmental employees, teachers, and students, provided they do not have immigrant status in the country imposing the tax.

Article 7. Income from real property.

The proposed treaty provides that income from real property may be taxed in the country where the real property is located. Income from real property includes income from the direct use or renting of the property and gains on the sale, exchange, or other disposition of the property. It also includes royalties and other payments in respect of the exploitation of natural resources (e.g., oil wells) and gains on the sale, exchange or other disposition of the royalty rights on the underlying natural resource.

Article 8. Business profits

Under the proposed treaty, business profits of a resident of one country are taxable in the other country only to the extent they are attributable to a permanent establishment which the resident has in the other country.

In computing the taxable business profits, the deduction of all expenses, wherever incurred, which are reasonably connected with the business profits are allowed. Deductible expenses include executive and general administrative expenses, wherever incurred. However, no deduction shall be allowed for amounts paid by the permanent establishment as: royalties, fees or other payments in return for use of patent rights or other rights; commissions for specific services performed for management; and interest on loans to the permanent establishment (other than bank loans).

The profits of a permanent establishment are determined on an arm's-length basis. Thus, there is to be attributed to it the business profits which would reasonably be expected to have been derived if it were an independent entity engaged in the same or similar activities under the same or similar conditions and dealing at arm's-length with the resident of which it is a permanent establishment. Moreover, the treaty adds a rule providing that profits derived from business activities similar to those effected through the permanent establishment can be attributed to the permanent establishment if the activities were structured to avoid taxation.

Business profits will not be attributed to a permanent establishment merely by reason of the purchase of merchandise by the permanent establishment (or by the resident of which it is a permanent establishment) for the account of that resident. Thus, where a permanent establishment purchases goods for its head office, business profits attributed to the permanent establishment with respect to its other activities will not be increased by any profit element on its purchasing activities.

For purposes of the proposed treaty, the term "business profits" includes income derived from any trade or business (regardless of the form of business structure used) including the rental of tangible movable property.

Article 9. Shipping and air transport

Unlike other U.S. tax treaties, the treaty provides that both countries may tax the profits from sources within one country derived from the operation of ships and aircraft in international traffic by a resident of the other country. The treaty places no limitation on the source country's right to tax income of a resident of the other country derived from the operation of aircraft in international traffic. In the case of shipping profits, however, the tax imposed by the source country may not exceed 1.5 percent of the gross revenues derived from sources within that country (which, as determined under Article 4, is income from outgoing traffic originating in that country), or, if less, the lowest rate of Philippine tax which may be imposed on shipping profits of a resident of a third country under other Philippine tax treaties.

The treaty does not provide for exemption of shipping and air transport income derived from international traffic because the Philippines, unlike most countries (including the United States in most situations), imposes a tax on the earnings of foreign residents providing transportation services out of the Philippines; the Philippine tax is generally 2½ percent of gross revenues. Thus, the treaty lowers the rate of tax (from 2½ percent to 1½ percent) which U.S. shippers must pay, although no reduction is provided for operators of U.S. aircraft.

The treaty is not, however, likely to affect any Philippine resident shipping into or out of the United States since the U.S. tax imposed under the Internal Revenue Code is substantially less than that permitted by the treaty. The Internal Revenue Code includes as U.S. source income only that amount of shipping income attributable to shipping within U.S. waters (using the 3-mile limit). Thus, regardless of the treaty limitation, a Philippine resident shipping in international commerce would be subject to U.S. tax on only a very small portion of his income.

Since the Philippine Government grants to Philippine air carriers (other than Philippine Airlines) and to Philippine shipping countries recurring 10-year exemptions from tax on income derived from international traffic and since Philippine Airlines is subject to tax on a different basis, the treaty provision could result in U.S. air carriers and shippers being subject to more burdensome taxation in the Philippines than these Philippine residents. This would not violate the non-discrimination provision (Article 24) because of specific exceptions provided in this article for the taxation of income from the operation of aircraft. However, neither this provision nor the nondiscrimination provision prevents the President from adjusting the U.S. income tax on Philippine shippers and air carriers (under Code sec. 896) to retaliate against this discrimination. What impact, if any, such retaliation would have is not known.

This provision also applies to income derived by residents through participation in a pool, a joint venture, or an international operating agency.

Article 10. Related persons

The proposed treaty, like most other U.S. tax treaties, contains a provision similar to section 482 of the Internal Revenue Code which recognizes the right of each country to make an allocation of income in the case of transactions between related persons, if an allocation is necessary to reflect the conditions and arrangements which would have been made between unrelated persons.

It is anticipated that when a redetermination has been made by one country with respect to the income of a related person, the other country will attempt to reach an agreement with the first country in connection with the redetermination and, if it agrees with the redetermination, it will make a corresponding adjustment to the income of the other person.

Article 11. Dividends

The proposed treaty limits the rate of withholding tax imposed by either country to 25 percent on dividends paid to residents of the other country generally and to 20 percent on dividends paid to corporations which have at least a 10-percent ownership interest in the paying corporation.

As other treaties have provided, dividends which are effectively connected to a permanent establishment in one country or to a fixed base of an individual performing independent personal services in that country are to be treated as business profits (and taxed under Article 8) or income from the performance of personal services (treated under Article 15), rather than as dividends.

The treaty also provides that dividends paid by a corporation of one country to a person other than a citizen or resident of the other country is to be subject to tax in the other country only if such dividend is from sources within the other country or the recipient of the dividend has a permanent establishment or fixed base in the other country and the stock with respect to which the dividend is paid is effectively connected with the permanent establishment or fixed base.

The Article specifically provides that nothing in the treaty is to prevent the Philippines from imposing its additional tax on branches of foreign corporations in a manner similar to the withholding tax permitted on distributions from Philippine corporations which are 10 percent or more owned by U.S. residents. Under the provision, the Philippines may levy an additional tax of up to 20 percent of earnings (net of the regular Philippine income tax) of a permanent establishment of a corporation other than a Philippine corporation.

Article 12. Interest

The proposed treaty generally limits the withholding tax on interest derived by a resident of one country from sources within the other country to 15 percent of the gross amount of interest paid. However, a special exception is established for interest derived from publicly issued bonds, which are subject to a 10-percent withholding rate.

The reduced rates of withholding tax on interest will apply unless the recipient has a permanent establishment in the source country or performs independent personal services from a fixed base in that country and the interest is effectively connected with the permanent estab-

lishment or the fixed base. Interest effectively connected with a permanent establishment or the fixed base will be taxed under the business profits provisions (Article 8) or the independent personal services provision (Article 15), as the case may be. This treatment generally conforms to that provided by other recent U.S. tax treaties and the OECD model tax treaty.

The proposed treaty also provides that interest derived beneficially by either country, or by a tax-exempt instrumentality of either country, will be exempt from tax by the other country. Under this rule income derived by the Export-Import Bank of the United States and the Overseas Private Investment Corporation (OPIC) on loans made to Philippine residents will be exempt from tax by the Philippines. This exemption also applies where a resident of one country receives interest income on debt obligation guaranteed or insured by that country or an instrumentality of that country.

The proposed treaty defines interest as income from debt-claims of every kind (whether or not the claim carries a right to participate in the debtor's profits). In situations where the payor and recipient are related, the interest provision of the proposed treaty only applies to the amount of interest to that which would have been paid had they not been related.

Article 13. Royalties

Under the proposed treaty, the withholding tax imposed by the United States on royalties derived by a resident of the Philippines is limited to 15 percent of the gross amount of the royalty. The withholding tax on royalties imposed by the Philippines is generally limited to 25 percent of the gross amount of the royalties. However, if the royalties are paid by a corporation which is registered with the Philippine Board of Investments and is engaged in preferred areas of activity, the withholding tax is limited to 15 percent of the gross amount of the royalties. In no case is either the 25-percent or the 15-percent limitation to exceed the lowest withholding rate of Philippine tax which may be imposed on similar types of royalties paid to residents of a third State. Thus, U.S. residents will automatically receive the benefits of any lower withholding rates on royalties established in Philippine tax treaties with any third country.

Under the entry-into-force provisions (Article 29, paragraph (2)), the provision giving U.S. residents the benefit of lower withholding rates established in other Philippine treaties is not to take effect until January 1, 1979, with respect to payments for the use of, or the right to use, films or radio or television films or tapes. Since the Philippines has existing treaties with Sweden and Denmark establishing a 10-percent withholding on royalty payments for films and radio and television tapes or films, beginning in 1979 U.S. residents will be subject to the same 10-percent rate with respect to those types of royalties unless the Swedish and Denmark treaties are renegotiated.

Royalties are defined in the proposed treaty as payments of any kind made as consideration for the use of, or the right to use, copyrights of literary, artistic, or scientific works, and payments of any kind made as consideration for the use of, or the right to use, patents, designs, models, plans, secret processes or formulas, trademarks, or other like property or rights. Payments made for the use of or the right to use motion picture films or films or tapes used for radio or

television broadcasting are also treated as royalties. Royalties include gains derived from the sale, exchange, or other disposition of such property or rights to the extent the amounts received are contingent on the productivity, use, or disposition of the property or rights. If the amounts realized are not contingent, the provisions of Article 14 (Capital gains) may apply.

The reduced withholding rates do not apply where the recipient has a permanent establishment or performs services from a fixed base in the source country and the royalties are effectively connected with the permanent establishment or the fixed base. If the royalty is effectively connected with a permanent establishment or fixed base, then it will be taxed under the business profits provision (Article 8) or the independent personal services provision (Article 15).

As in the case of the interest provision, the royalty provision does not apply to that part of a royalty paid to a related person which is considered excessive.

Article 14. Capital gains

The proposed treaty generally provides that capital gains derived by a resident of one country (including gains from real property) will be exempt from tax by the other country. However, the exemption does not apply to sales of tangible personal property of a resident of one country which form part of the business property of a permanent establishment or of a fixed base used to perform independent personal services in the other country. These gains are fully subject to tax in the other country, except that gains from the sale of ships, aircraft or containers operated by a resident of one country in international traffic are not to be subject to tax in the other country.

Article 15. Independent personal services

Under the proposed treaty, income from the performance of independent personal services (i.e., services performed as an independent contractor, not as an employee) in one country by a resident of the other country is exempt from tax in the country where the services are performed, unless (i) the person performing the personal service has a fixed base regularly available to him in the one country for the purpose of performing the activities, (ii) is present in the country for 90 or more days during the taxable year, or (iii) receives gross remuneration from residents of the country for such services in excess of \$10,000 (or the equivalent amount in Philippine pesos). This provision does not apply to income derived by public entertainers (theater, motion picture, radio and television artists, musicians, and athletes), which is governed by Article 17.

Article 16. Dependent personal services

Under the proposed treaty, income from services performed as an employee in one country (the source country) by a resident of the other country will not be taxable in the source country if four requirements are met: (1) the individual is present in the source country for less than 90 days during the taxable year; (2) the individual is an employee of a resident of the source country or of a permanent establishment in the source country; and (3) the compensation is not borne by a permanent establishment of the employer in the country of his residence.

Compensation derived by an employee aboard a ship or aircraft operated by a resident of one country in international traffic is exempt from tax by the other country, provided that the employee is a member of the regular complement of the ship or aircraft.

Article 17. Artists and athletes

This proposed treaty provides that, notwithstanding Articles 15 (Independent personal services) and 16 (Dependent personal services), income derived by an individual resident of one country from the performance of personal services in the other country as a public entertainer, such as a theater, motion picture, radio or television artist, a musician or an athlete may be taxed by the other country, but only if the gross amount of such income exceeds \$100 for each day the individual is present in the other country for the purpose of performing such services therein or a total of \$3,000 per year.

However, income from activities supported or sponsored by the government of one country (and for which the entertainer or athlete is certified by that government) is exempt from tax by the host country.

In addition, income with respect to the above types of activities which accrues to another person is to be taxed in the State where the activity is conducted without regard to the rules which would otherwise apply under other Articles of the treaty.

Article 18. Private pensions and annuities

Under the proposed treaty, annuities paid to residents of one country are exempt from tax by the other country. In addition, child support payments paid by a resident of one country to a resident of the other are exempt in the recipient's country. However, unlike most U.S. treaties, this treaty does not provide that private pensions or alimony payments are taxable only in the country of residence. Instead the treaty provides that private pensions and other similar remuneration is to be taxable in the country where the employment services were rendered. However, both countries would remain able to tax their residents and, under the saving clause of Article 6, their citizens on pensions received from the other country (subject to allowance of a foreign tax credit).

Article 19. Social security payments

Under the proposed treaty, social security payments and other public pensions paid by one country to residents of the other are to be taxable only in the source country.

Article 20. Governmental functions

Under the proposed treaty, wages, including pensions or similar benefits, paid by one country to a citizen of that country for labor or personal services performed for that country in the discharge of governmental functions of the national government of that country is exempt from tax by the other country. This exemption also applies to citizens of any third country who come to the other country expressly for the purpose of performing such services.

Article 21. Teachers

The proposed treaty provides that a teacher or researcher who is a resident of one country will be exempt from tax in the other country on income from teaching or engaging in research in the host country if he is present in that country for a period not expected to exceed two

years. The exemption applies only if the individual comes to the other country primarily for the purpose of teaching or engaging in research pursuant to an invitation of the host country or a recognized educational institution of the host country. It is not to apply with respect to income from research which is undertaken primarily for the benefit of a specific person or persons. If the teacher or researcher remains in the other country for a period exceeding two years, the exemption only applies to income earned during the 2-year period.

Article 22. Students and trainees

Under the proposed treaty, residents of one country who become students in the other country will be exempt from tax in the host country on gifts from abroad used for maintenance or study and on any grant, allowance or award. In addition, a \$3,000 annual exemption from tax by the host country is provided for personal service income (such as income from a part-time job) derived from sources within the country in which the individual is studying.

These exemptions and the visiting teachers' exemption (Article 22) may only be utilized for a period of 5 years plus any additional period of time necessary to complete educational requirements as a candidate for a post-graduate or professional degree from a recognized institution. In addition, the benefits under the teachers' article are not available to an individual if, during the immediately preceding period, the individual received the benefit of the student provision.

In addition to the exemption regarding students, the proposed treaty follows the approach of other recent U.S. tax treaties and provides a limited exemption for personal service income of residents of one country who are employees of a resident of that country and who are temporarily present in the other country to study at an educational institution or to acquire technical, professional, or business experience. This exemption is available for a period of 12 consecutive months and is limited to \$7,500. The proposed treaty also provides an exemption for income from personal services performed in connection with training, research, or study by residents of one country who are temporarily present in the other country as participants in Government-sponsored training programs. This exemption is limited to \$10,000.

If an individual qualifies for the benefits of more than one of the provisions of this article, the individual may choose the most favorable provision but may not claim the benefits of more than one provision in any taxable year.

Article 23. Relief from double taxation

Under the proposed treaty, each country agrees to provide its citizens and residents with a foreign tax credit for the appropriate amount of income taxes paid to the other country. The credits allowed under this provision are subject to the provisions of U.S. or Philippine law applicable to the year in question.

The proposed treaty also provides that a deemed-paid foreign tax credit will be made available to a United States corporation with respect to dividends from a Philippine corporation in which it has at least a 10-percent ownership interest. In this case, a credit will be allowed for the Philippine corporate tax paid on the earnings out of which the dividend is paid. (A deemed-paid foreign tax credit satisfying the treaty requirements is presently provided under the Internal Revenue Code.) Similarly, the proposed treaty provides that the

Philippines is to provide a deemed-paid foreign tax credit for U.S. tax attributable to dividends received by Philippine corporations from U.S. corporations in which they are 50-percent shareholders.

For the purpose of applying the U.S. foreign tax credit in relation to taxes paid to the Philippines, the rules set forth under Article 4 will be applied to determine the source of income. The Philippine taxes which the proposed treaty provides are creditable for U.S. tax purposes are the income taxes imposed by Title II of the National Internal Revenue Code of the Philippines, but not including the accumulated earnings tax or personal holding company tax.

Under an exchange of notes (dated November 24, 1976), it was agreed that citizens of the Philippines who reside outside of that country may be permitted only a deduction rather than a credit for U.S. income taxes for Philippine tax purposes. These Philippine citizens are currently subject to Philippine tax at rates not exceeding 3 percent of worldwide income. The exchange of notes indicates that in the event these rates are increased, the treaty would require the Philippine Government to grant their nonresident citizens a foreign tax credit for U.S. taxes paid.

Article 24. Nondiscrimination

The proposed treaty contains a comprehensive nondiscrimination provision relating to taxes imposed at the national, State or local level, similar to provisions which have been embodied in other recent U.S. income tax treaties, except that the treaty permits certain Philippine incentive programs to be limited to Philippine citizens or corporations. Generally, one country cannot discriminate by imposing more burdensome taxes on its residents who are citizens of the other country, or on permanent establishments of residents of the other country, than it imposes on comparable taxpayers who are resident citizens of the first country. This provision does not, however, require either country to grant to residents of the other country the personal allowances, reliefs, or deductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents. The nondiscrimination provision also applies to corporations of one country which are owned by residents of the other country.

However, the article provides that the Philippines may limit to its citizens and corporations the benefits from the income tax incentive provided under the Philippine Investment Incentives Act, the Export Incentives Act, and the Investment Incentives Program for the tourism industry. The treaty provides that these exceptions to the nondiscrimination provisions are permitted only for these incentive programs to the extent they were in effect on, and have not been modified in any substantial way since, the date of signature of the treaty (October 1, 1976). In addition, other similar incentives provided by the Philippines or by political subdivisions or local authorities of the Philippines may similarly be limited to Philippine citizens and corporations to the extent they were in effect on the date of signature and have not since been substantially modified.

Articles 25 and 26. Administrative provisions

The proposed treaty contains various administrative provisions generally along the lines of the provisions contained in other U.S. tax treaties. In general, the proposed treaty provides for—

(1) consultation and negotiation between the two countries to resolve differences arising in the application of the proposed treaty and also to resolve claims by taxpayers that they are being subjected to taxation contrary to the terms of proposed treaty; and

(2) the exchange between the countries of information pertinent to carrying out the provisions of the proposed treaty and of the domestic laws of the countries concerning taxes covered by the proposed treaty.

An exception is provided to the usual provision that adjustments made under the treaty procedures for resolving disagreements can be made without regard to either country's statute of limitation. Under the exception, the Philippine statute of limitation will apply, but, in certain cases where refunds would otherwise be due, the Philippine Government will instead give "tax certificates" which can be used to pay any subsequent Philippine tax (but for which no refund is allowed). For U.S. tax purposes, receipt of these certificates is to be treated as a refund of Philippine tax and the subsequent credit of the certificates against Philippine tax is to be treated as the payment of that tax.

Article 27. Assistance in collection

The provision requires that each country aid in collecting the taxes of the other country to the extent necessary to insure that exemptions or reduced rates of tax under the treaty are not enjoyed by persons not entitled to its benefits.

Article 28. Diplomatic and consular officials

The proposed treaty contains the rule found in other U.S. tax treaties that its provisions are not to affect the fiscal privileges of diplomatic and consular officials under the general rules of international law or the provisions of special agreements.

Article 29. Entry into force

The proposed treaty will enter into force 30 days following the exchange of the instruments of ratification. It will become effective, with respect to withholding tax rates for amounts paid on or after, and, with respect to all other taxes for taxable years beginning on or after, January 1st of the year following the date on which the proposed treaty comes into force. An exception is provided with respect to the provision dealing with film royalties, which will not become effective until January 1, 1979.

Article 30. Termination

The proposed treaty will continue in force indefinitely, but either country may terminate it at any time after 5 years from its entry into force by giving at least 6 month's prior notice through diplomatic channels. If terminated, the termination will be effective with respect to income of taxable years beginning (or, in the case of withholding taxes, payments made) on or after January 1 immediately following the expiration of the 6-month period.

The following table shows the results of the experiment. The first column is the number of trials, the second column is the number of correct responses, and the third column is the percentage of correct responses.

Number of trials	Number of correct responses	Percentage of correct responses
10	8	80%
20	15	75%
30	22	73%
40	28	70%
50	35	70%
60	42	70%
70	48	69%
80	55	69%
90	62	69%
100	68	68%