Overview of U.S. Tax Treaties
(Prepared April 17, 2020)

I. What Are Tax Treaties and What Do They Do?

A. U.S. tax treaties are typically bilateral agreements in which the United States agrees to limit its taxation of residents of another country in exchange for similar concessions by the other country.

B. There are multilateral agreements that modify bilateral tax treaties, such as the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (and of which the United States is not a signatory). However, most truly multilateral agreements regarding taxes to which the United States is a signatory, such as the Convention on Mutual Assistance in Tax Matters, deal with tax administration and enforcement rather than provide benefits to individuals and companies in the signatory countries as do bilateral tax treaties.

C. The United States currently has comprehensive income tax treaties with 66 countries.

1. Armenia (succeeded to the U.S.-U.S.S.R. income tax treaty)
2. Australia
3. Austria
4. Azerbaijan (succeeded to the U.S.- U.S.S.R. income tax treaty)
5. Bangladesh
6. Barbados
7. Belarus (succeeded to the U.S.- U.S.S.R. income tax treaty)
8. Belgium
9. Bulgaria
10. Canada

11. China
12. Cyprus
13. Czech Republic
14. Denmark
15. Egypt
16. Estonia
17. Finland
18. France
19. Georgia (succeeded to the U.S.- U.S.S.R. income tax treaty)
20. Germany
21. Greece
22. Hungary
23. Iceland
24. India
25. Indonesia
26. Ireland
27. Israel
28. Italy
29. Jamaica
30. Japan
31. Kazakhstan
32. Korea (Republic of)
33. Kyrgyzstan (succeeded to the U.S.- U.S.S.R. income tax treaty)
34. Latvia
35. Lithuania
36. Luxembourg
37. Malta
38. Mexico
39. Moldova (succeeded to the U.S.- U.S.S.R. income tax treaty)
40. Morocco
41. Netherlands
42. New Zealand
43. Norway
44. Pakistan
45. Philippines
46. Poland

47. Portugal
48. Romania
49. Russia
50. Slovak Republic
51. Slovenia
52. South Africa
53. Spain
54. Sri Lanka
55. Sweden
56. Switzerland
57. Tajikistan (succeeded to the U.S.- U.S.S.R. income tax treaty)
58. Thailand
59. Trinidad
60. Tunisia
61. Turkey
62. Turkmenistan (succeeded to the U.S.- U.S.S.R. income tax treaty)
63. Ukraine
64. United Kingdom
65. Uzbekistan (succeeded to the U.S.- U.S.S.R. income tax treaty)
66. Venezuela

There are also signed treaties with Chile and Vietnam which have not yet been ratified by the United States.

D. Historically, the goal of a comprehensive, bilateral income tax treaty has been to mesh the tax systems of the two countries. The tax treaty therefore:

1. Seeks to resolve conflicts when the tax authorities of both countries view a person as a resident for tax purposes;
2. Clarifies and allocates taxing rights between the "source" country (the country where the income is earned) and the "residence" country (the country where the taxpayer is subject to tax as a resident), generally assigning primary taxation rights to one

country and residual taxation rights to the other country and identifying when one country has to forego taxation rights or provide a credit for taxes paid in the other country;

3. Reduces or eliminates source country withholding taxes to prevent excessive taxation;
4. Grants some protection against discriminatory taxation by the source country; and
5. Provides a mechanism for resolving disputes between (a) the tax authorities of one country and a person resident in the other country and (b) between the tax authorities of the two countries.

E. Tax treaties are increasingly being used, however, as a tool of tax enforcement as well.

1. Tax treaties have traditionally allowed the tax authorities of the two countries to exchange information and to address potential tax avoidance or evasion in one or both countries.
2. Recent changes to tax treaties (and tax treaty policy) as part of the OECD "Base Erosion and Profits Shifting" project have generally resulted in tax treaties providing less benefits to taxpayers and more powers to tax authorities.

F. In addition to comprehensive income tax treaties, the United States has hundreds of agreements that address taxes in a more limited way:

1. Estate and/or gift tax treaties,
2. Intergovernmental agreements implementing FATCA;
3. Tax information exchange agreements,
4. Shipping and/or aircraft agreements,
5. Two tax treaties with very limited scope (Bermuda and Netherlands Antilles), and

6. Trade agreements, diplomatic agreements, and military agreements that have tax provisions specific to their scope.

II. General Provisions of U.S. Income Tax Treaties

A. Although each U.S. income tax treaty includes provisions that are specific to that treaty, U.S. income tax treaties are generally consistent with the U.S. model income tax convention (last updated in February 2016). The U.S. model income tax convention is very similar to the OECD model income tax convention, although the U.S. model income tax convention includes certain provisions not found in the OECD model income tax convention. A U.S. comprehensive income tax treaty generally

1. Provides benefits only to persons who are a resident of one (or both) of the two countries;
2. Only provides benefits; it does not restrict or reduce benefits otherwise available under domestic law or another agreement;
3. Includes a "saving clause" to preserve U.S. taxing rights over U.S. citizens and residents (and, in certain cases, former U.S. citizens and residents); and
4. Generally does not provide additional U.S. tax benefits to U.S. persons (except in very limited circumstances).

B. U.S. income tax treaties specifically limit the power of a country to tax a resident of the other country:

1. Business profits (sales, services, etc.) of a company resident in one country generally are not subject to tax in the other country unless the company has a "permanent establishment" in the other country;

2. Dividends paid by a company resident in one country to a person resident in the other country generally are subject to a reduced (generally 15%) rate of withholding tax by the source country, with the rate lowered further to 0% or 5% in certain instances;
3. Interest paid by a person resident in one country to a person resident in the other country generally is subject to a reduced (generally 0% or 10%) rate of withholding tax by the source country;
4. Royalties paid by a person resident in one country to a person resident in the other country generally are subject to a reduced (generally 0% or 10%) rate of withholding tax by the source country;
5. Gains realized by a person resident in one country attributable to disposition of property located in the other country generally are not subject to tax in the other (source) country unless the gain is real estate-related or part of a permanent establishment in the other (source) country;
6. Cross-border employment income is generally not subject to tax in the source country unless certain thresholds are met; and
7. Special rules apply to
   i. real property,
   ii. shipping and air transport,
   iii. transactions between related parties,
   iv. entertainers and athletes,
   v. pensions and social security, and
   vi. students and trainees (and often teachers and researchers).

C. Although the specific provisions vary by treaty, nearly all U.S. income tax treaties also include the following provisions:

1. A “limitation on benefits” article to prevent residents of a third country from establishing a business in, or routing income through, the other

country simply to obtain U.S. tax benefits from the tax treaty;

2. Specific rules to ensure that each country relieves double taxation;
3. Rules to prevent discriminatory tax provisions;
4. Procedures for resolving tax disputes between tax authorities of the two countries (the “competent authorities”); and
5. Provisions for exchange of information between the competent authorities.

III. How Tax Treaties Are Developed

A. Tax treaty negotiations are led by the Office of the International Tax Counsel in the Treasury Department. The State Department plays a role, but a reduced role compared to most treaties.

B. Prioritizing countries and treaties. When it comes to new U.S. income tax treaties, the demand has historically exceeded the supply, although the lengthy delays in the tax treaty approval process by the Senate may have dampened enthusiasm of potential treaty partners.

1. New treaty partners. Lots of countries want a tax treaty with the United States but
   - i. a potential treaty partner may not be able to offer reciprocal concessions (i.e., the United States does not enter into tax treaties with countries that do not have an income tax or where there is no potential for significant double taxation) or
   - ii. a potential treaty partner may want provisions to which the United States cannot agree (like tax sparing) or does not want provisions upon which the United States insists (like a detailed limitation on benefits article).

2. Updating existing tax treaties. Changes in law or policies in one or both countries may cause one or both countries to want to renegotiate the existing tax treaty.
3. Reactions from the business community. The Treasury Department communicates regularly with the U.S. business community, seeking input regarding both specific experiences (e.g., problems encountered under particular treaties and particular tax regimes) and general needs (e.g., where the U.S. tax treaty network needs to be expanded or improved).
4. Likely future developments. Historically, the U.S. focus has been on ensuring that its tax treaty network fulfills the twin goals of facilitating cross border trade and investment and preventing tax avoidance and evasion.

C. Approval by the U.S. Senate

1. The Treasury Department traditionally works closely with the Senate Foreign Relations Committee which has jurisdiction over treaties.
2. The tax treaty approval process differs significantly from the tax legislative process.
    i. For approval of a treaty, only the Senate (and not the House of Representatives) votes, and a 2/3 majority is needed.
    ii. In contrast, legislation has to pass both Houses, and the committees of jurisdiction are the House Ways and Means Committee and the Senate Finance Committee (either of which can seek to override a tax treaty if they are not happy with it).
3. Although the Senate last year approved several protocols amending existing income tax treaties, no full income tax treaty has been approved by the Senate in more than nine years. This has led to a backlog of negotiated, but not yet effective, new tax

treaties with Chile, Hungary, and Poland.

IV. Implementation and Interpretation of Tax Treaties

A. Interpretation of U.S. tax treaties

1. The Technical Explanation to the tax treaty, prepared by the Treasury Department and submitted to the Senate Foreign Relations Committee, provides guidance in interpreting the tax treaty from a U.S. standpoint (OECD Commentary and international norms are important when dealing with other country's tax authorities).
2. When it comes to interaction of a tax treaty and domestic U.S. tax laws, U.S. domestic law and tax treaties have equal weight (see Internal Revenue Code section 7852(d)). Thus, regular interpretive conventions apply when U.S. domestic law and a tax treaty provide different rules (e.g., "later in time" rule, "specific over the general" rule).

B. Resolution of disputes under tax treaties and the role of the competent authority process

1. <u>Discussions between the competent authorities</u>. Under U.S. tax treaties, the competent authorities are to consult generally and to reach agreements in specific cases.
   i. <u>Notification and Coordination Generally</u>. The competent authorities notify each other of changes in their laws and discuss and coordinate regarding legal and administrative matters.
   ii. <u>Mutual Agreement Procedure</u>. Under a U.S. tax treaty, when a U.S. taxpayer believes that the tax treaty has not been properly applied, the taxpayer can bring the matter to the U.S. competent authority. The U.S. competent authority will then seek to resolve the matter

with the competent authority of the treaty partner.

2. Arbitration. Several recent tax treaties have included arbitration provisions to facilitate resolution of disputes between the competent authorities
   i. Germany
   ii. Belgium
   iii. Canada
   iv. France
   v. Switzerland
   vi. Japan
   vii. Spain

V. Importance of Tax Treaties to Taxpayers

A. Tax treaties provide greater certainty as to tax treatment in a particular country.

1. When a person has links to two countries, a tax treaty between the two countries generally resolves which country can tax the person on a "residence" basis (although not always for dual resident corporations).

2. The permanent establishment threshold is often a brighter line test than the taxation threshold under domestic law (e.g., the "U.S. trade or business" test), making it easier for companies to know which actions would cause them to incur filing and income tax responsibilities with respect to a particular country.

3. However, the "limitation on benefits" article in U.S. tax treaties sometimes makes it difficult to determine whether a person is eligible for benefits of the tax treaty.

B. Tax treaties reduce instances of double or excessive taxation.

1. Withholding tax rates on dividends, interest, and royalties are reduced or eliminated. Because withholding taxes are typically imposed on a gross basis, the amount of withholding tax imposed pursuant to domestic law can be a very high percentage of net income.

2. U.S. tax treaties often include special rules to relieve double taxation, such as rules that "re-source" U.S. source income as foreign source income for U.S. foreign tax credit purposes, and provisions to coordinate U.S. and foreign taxes for U.S. citizens and residents subject to U.S. tax under the "saving clause."

C. Tax treaties provide a mechanism for resolving cross-border tax disputes.

1. A taxpayer that believes that it has been taxed by one of the countries in a manner inconsistent with the tax treaty may bring its case to the competent authorities for relief.

2. Competent authorities also can resolve problems for categories of taxpayers through the mutual agreement procedure.