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IFA's Growth with International Tax Law

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The development of international tax law, primarily through treaties to prevent the taxation by two or more countries of the same income or property, was selected as its goal by the International Fiscal Association (IFA) when it was founded in the Chamber of the World Court in the Peace Palace at The Hague in 1938, and when it held its first congress in that city in 1939.

IFA's Continuous Relations with Makers of International Tax Law

In 1938 at the Palais des Nations, Geneva, the League of Nations Fiscal Committee, composed for the most part of the principal tax officials of the leading European countries, elected the author as their president although at the time he was a private citizen who had been a special attorney in the U.S. Treasury, and in 1930 had participated in negotiating the first tax treaty of the United States with France, signed April 27, 1932. Subsequently for the League Committee, he had conducted in some 30 countries around the world, a survey of their legislative provisions and methods used in allocating income and expense to sources within and without each country.

The findings were synthesized in a model convention, approved by the Fiscal Committee in 1935, which supplemented the general model conventions previously adopted by a conference of governmental experts at Geneva in 1928. In 1934 he was appointed a member of the Fiscal Committee, and in 1938 was elected its chairman. The Committee decided to look into the extent to which the League model conventions should be

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amended to take into account the provisions in bilateral treaties which were based thereon, but improved upon the model.

In 1939 the Chairman was invited to attend the first Congress of the International Fiscal Association at The Hague. Dr. C. W. Bodenhausen, who had headed the Netherlands Indies Department of Finance and had served as IFA's President, was appointed by the Queen to be the Netherlands Minister of Finance. IFA elected the young American attorney, who was Chairman of the League of Nations Fiscal Committee, to take his place. This resulted in a close rapport between IFA and the League's Fiscal Committee and its members, correspondent members, and others who had collaborated with him in the making of the world survey.

The subject of the IFA Congress of 1939 was the contribution made to international tax law by the Fiscal Committee and the groups which preceded it. The general reporter was a young Professor Jean von Houtte from the University of Ghent. He subsequently became the Belgian Minister of Finance twice, also the Prime Minister, a Senator, and Councillor of State, and more recently he was appointed President of Sabena Airlines. In recognition of his extraordinary service to Belguim, King Baudouin made him a hereditary baron. The IFA Assembly at the Brussels Congress last year unanimously nominated him to succeed, as President, the American who had served in that capacity since 1939, and had been reelected to continue in office until the end of the 1971 Congress.

IFA's Leaders Attending the Washington Congress

IFA has 23 national branches and over 4,000 members in 73 or more countries. Its Secretary General is Prof. Dr. J. H. Christiaanse of the Netherlands School of Economics, Rotterdam, where IFA has its head office. The three Vice Presidents, all of whom expect to attend the Congress in Washington October 4-8, 1971, are Prof. Edgar Schreuder, former Belgian Director General of Taxes, former General Secretary of the Belgian Ministry of Finance and President of last year's IFA Congress in Brussels; Dr. Paul Gmür, a prominent attorney in Zurich, who is President of the Swiss Branch, and of the Congress scheduled to take place, probably in Zurich, in 1973; and Mr. Alun Davies, a former British Inspector of Taxes, who is Executive Director of the Rio Tinto Zinc Company, and President of the U. K. Branch.

Many of the officials of tax administrations in Europe and other countries are expected to attend this meeting, with corporate tax executives, professors, lawyers, accountants and others, all of whom are concerned

with taxation from an international point of view. The host of the Washington Congress is the U. S. A. Branch, headed by Dr. Malcolm Andresen, Tax and Legal Director, National Foreign Trade Council, Inc. The Secretary General is Mr. Richard Hammer, Partner, Price Waterhouse & Co.; and the Vice President in charge of Finance is Mr. Julian Phelps of Lybrand Ross Brothers & Montgomery.

Brief History of IFA's Congresses

IFA's first Congress at The Hague, July 12-15, 1939, ended with great expectations.[1] Unfortunately they had to be postponed when World War II broke out the following September. When Holland was occupied, the Dutch Secretary General, Dr. Emmen Riedel, literally took IFA underground. However, IFA emerged as soon as hostilities ceased and the valiant Dutch proceeded to hold a second Congress at The Hague, September 11-13, 1947. The Italian members invited IFA to convene in Rome the following year in the Palazzo used by Mussolini on the Piazza di Venezia.

The succeeding three Congresses were in the tax-free ambiance of Monte Carlo, then Zurich, and Brussels in 1952. Prof. van Houtte had become Prime Minister of Belgium, and in behalf of King Baudouin he honored IFA by awarding its President the rosette of an officer of the Order of Leopold I.

In 1953 IFA convened in Paris, then Cologne, Amsterdam, Rome, Vienna, Knocke (Belgium), Madrid, Basle, Jerusalem and Athens. It met in Paris again in 1963, when the Association celebrated its 25th birthday. The subjects on the agenda on this occasion were the taxation of mergers and of investments in developing countries.

In Hamburg, 1964, IFA strongly supported the principle of respecting, for tax purposes, the separate legal entity of a corporation, and generally accepted principles of fiscal jurisdiction. Then in 1965 the group met in London, and the following year in Lisbon where tax problems of the EEC and EFTA were discussed.

The Stockholm Congress questioned recourse to taxes to stabilize economic conditions, and examined developments in the treaty concept of the permanent establishment as the basis for taxing business income.

At Montevideo, Uruguay, which is a prime example of a less developed country, the main subject was the relation between fiscal systems and

[1]For the story of the growth of IFA, *see* Carroll, IFA—Thirty Years of Progress in International Law, with a foreword by Prof. Edgar Schreuder, Senior Vice President, IFA News, No. 33, September 1969.

economic development. In Rotterdam in 1969, when IFA's 30th Anniversary Congress was celebrated, attention was given to the timely subject of preventing double taxation of income from rendering services, and the licensing of patents and similar rights as between parent corporations and their foreign subsidiaries.

Two subjects of primary concern to the EEC Commission, which was represented at the Brussels Congress in 1970, were discussed there, namely (a) relief from multiple taxation of earnings passing as dividends from a subsidiary in one country to the mother corporation in another, and distributed to shareholders in the same or a third country; and (b) deferring the taxes until gains were realized in the case of mergers between companies in different countries.[2]

Fiscal Committee Accomplishments During World War II

When the battles of World War II prevented the carrying on of its work in Europe, the members of the Fiscal Committee's staff were given a refuge in the Institute of Advanced Studies at Princeton University. They and the President, who lived in New York, continued its activities by his arranging of two Regional Tax Conferences in Mexico City in 1940 and 1943. These meetings were attended by ranking officials in the tax administrations of many of the countries of Latin America, as well as of Canada and the United States. Having become the "arsenal of democracy" for the allies in the Second World War, the United States was fast becoming a developed country. On the other hand, seeing advantages in the treatment that less developed countries were claiming, Canada wanted to be classified as one.

Hence, at the meetings which the Fiscal Committee's Chairman brought about in Mexico City as guests of the Mexican Ministry of Finance, we melded the draft conventions on income taxation and on the allocation of business income to a permanent establishment. The result was a model convention heavily weighted in favor of developing countries, which was named the Mexico Model Convention.

After hostilities ceased, a final meeting of the Fiscal Committee took place in 1946 in London—where American participation in the League Committees of Technical Experts had begun in 1926. Articles on dividends, interest and royalties were modified to favor capital-exporting countries, and the document was called the London Model Convention.

When the United Nations was being structured, officials of the State

[2]The very informative national reports have been published and are obtainable from the International Bureau of Fiscal Documentation, Sarphatistraat 124, Amsterdam, Netherlands.

Department asked if a Fiscal Committee should be organized to carry on the work that had been done by the League Committee. The recommendation was strongly in the affirmative, and a new Fiscal Committee was created which met several times, and the President of IFA attended in a consultative capacity. Unfortunately, the opposition of certain elements in Eastern Europe led to its adjournment *sine die.*

All the while, the U.S.A. and other countries continued to use the London Model as a guide in negotiating bilateral conventions, which were discussed at the annual congresses of IFA. Then in 1958 the 18 European countries, which were beneficiaries of the Marshall Plan, formed the Organization for European Economic Cooperation (OEEC). It organized a Tax Committee and took the London Model Convention as a basis for formulating, in the light of the adaptations in numerous bilateral conventions to which the members were parties, an up-to-date model which was published in 1963. Admirers call it the Paris Model. Both the Chairman of this committee, Prof. Dr. A. J. van den Tempel and its Secretary, Mr. J. Gilmer, were members of IFA, and the Chairman often spoke on the progress that was being made. On Dr. van den Tempel's retirement in 1970, that committee, which had been enlarged when the OEEC became the OECD (Organization for Economic Cooperation and Development) to include the U.S.A., Canada and Japan, elected as its Chairman Mr. Nathan N. Gordon, Director of International Tax Affairs in the U. S. Treasury. He is a member of IFA.

Then a few years ago, the United Nations, after noting the progress made in tax treaties by developed countries, created an Ad Hoc Group of representatives of selected developed and developing countries, to work out a new model that could be used in framing bilateral tax treaties between countries in the two categories. They have held several meetings in Geneva. In view of the consultative status accorded to IFA by the Economic and Social Council, it has been represented at different times by its President and its Secretary General. Moreover, IFA has been invited by the United Nations to submit memoranda on certain topics that are distributed to members as working papers. The next meeting is scheduled to take place in Geneva the 24th of October, following the Congress in Washington.

Subjects for the Washington Congress

The Washington Congress will be opened with a speech of welcome by Dr. Malcolm Andresen, President of the U.S.A. branch who is in charge

of organizing the congress and will preside over the working sessions. The President of IFA, the world organization, will then thank the hosts on behalf of the members, especially those from abroad. He will provide a historical background for the inaugural address of the Secretary of the Treasury.

The subjects for the congress are, briefly (a) the allocation of taxable income and expense as between the parent corporation in one country and a subsidiary in another, and (b) the taxation of offshore mutual funds or investment trusts. The provisions in treaties regarding the types of income, and especially business income which involves allocation, are outlined *infra*.

IFA's Interest in Model Conventions and Tax Treaties

IFA's selecting as its inspiration the work done under the aegis of the League of Nations was logical because the Fiscal Committee, and the groups of technical experts which preceded it, endeavored to respond to the appeal made by the International Chamber of Commerce to free business enterprises trading or investing abroad, from the crushing burdens of double taxation. During World War II, tax rates had been raised to unprecedented levels to produce the revenues needed for the conflict. Tax officials found in the taxpayers present at the subsequent IFA Congresses a challenge to remove the cumulative burdens on the same property or income in order to promote prosperous economic relations between countries in all parts of the free world.

The pioneer work done by the League of Nations in the 1920s and 1930s culminated in the Model Conventions of Mexico in 1943 and London in 1946.[3]

While participating in the idealistic work of international organizations, United States officials have put theory into practice by concluding conventions with other countries.[4] When negotiating the Franco-American convention in the summer of 1930, the French Director General and the American naturally had recourse to the Model Conventions, prepared by the experts representing 27 governments at a world conference in Geneva in 1928, which both had helped to draft.

[3]*See* Carroll, *International Tax Law, Benefits for American Investors and Enterprises Abroad,* ABA, INTL. LAWYER July 1968, Vol. 2, No. 4, pp. 692-721.

[4]*See* Carroll, *Evolution of U.S. Treaties to Avoid Double Taxation of Income,* ABA, INT'L. LAWYER, October, 1968, Vol. 3, No. 1, pp. 129 to 172, and Vol. 3 Annex I.

Treaty Provisions on Dividends

As domestic corporations for the most part carry on business abroad through subsidiaries organized in the foreign country to operate a factory or a sales establishment, the principal category of income subject to double taxation is dividends. As a rule, the profit of the subsidiary is first subject to a company tax and then to a tax on the shareholder withheld when the profit is distributed. The credit for foreign taxes (Sections 901-905, I.R.C.) is applicable whether or not there is a treaty. A credit is granted against the U.S. tax on entire taxable net income for any tax withheld by the subsidiary from the dividend paid to the U.S. parent corporation.

Furthermore, if the domestic corporation receives dividends from a foreign corporation in which it owns at least 10% of the voting stock, it is deemed to have paid, and can include in the credit, a certain proportion of the company tax borne by the subsidiary itself, which corresponds to the dividend distributed to the parent. This concept is carried a step further, to cover the proportion of taxes corresponding to the income that passed through to the shareholder that is actually paid by a second-tier subsidiary in which the first tier owns at least 10% of the voting stock. By virtue of an amendment voted on the last day of 1970, the credit was extended to cover a third-tier foreign subsidiary in which the second-tier subsidiary owns 10% of the voting stock.

If the subsidiary is in a developed country, such as those in Europe, then for the purpose of the limitations on the credit, the foreign company is treated as if it were a branch and the dividend, which is actually paid out of the income of the subsidiary after tax, has to be "grossed up" by the corresponding amount of tax. This does not apply if the subisdiary is in a developing country.

The first treaty with France was negotiated in 1930 to induce France to cease taxing a distribution by a U.S. corporation, of dividends in the U.S.A., on the ground that the U.S. corporation owned the shares in a French subsidiary and therefore was deemed to have received dividends by reason of ownership of the stock. This was the case, even though the French company may have suffered a loss. Under the treaty signed in 1932, France agreed to respect the territorial limits on its jurisdiction, and tax only (a) dividends formally paid by the local subsidiary to the U.S. parent, and also (b) any "deemed dividend" consisting of profits improperly transferred to the parent. The treaty of July 28, 1967, uses the term "actually" distributed. [Art. 9(2)].

Canadian Protests Against U.S. Extra-territorial Taxation

In 1942, the Canadian tax administration began to protest to Washington because the U.S. was endeavoring to tax dividends and interest paid by a Canadian company in the Dominion, on the basis that the company derived a stated percentage of its income from U.S. sources.[5]

The U.S. treaties with France of 1932 and 1939 impliedly renounced this extra-territorial taxation and seventeen subsequent treaties expressly terminated the application outside the jurisdiction of the United States, of its tax on such dividends and interest. What is more significant is that in 1934, Congress introduced into the tax law what is now Section 891 I.R.C., which authorizes the President to double the rate of U.S. tax on the income derived by citizens or corporations of any foreign country which subjects American citizens and corporations to discriminatory or extra-territorial taxes.[6]

The French Treaty of 1967 provides in general for a 15% withholding rate, and in particular for 5% on dividends flowing from a local subsidiary to an American parent. This provision on rates is recommended by the OECD Tax Committee which took this formula from preceding U.S. treaties, and incorporated it in the Model Convention published in 1963.[7]

The provision for a general and a special rate has frequently been embodied in treaties to which the USA is a party, such as those with Denmark, New Zealand and the Netherlands. The rate of 15% for dividends paid to all non-residents is found in treaties with Belgium, Canada, the U.K., Ireland and Australia. In Japan, it is 15% in general and 10% in the case of dividends from a subsidiary. Germany, under certain conditions, reduces its rate to 15% for dividends from a 10%-owned subsidiary.

Austria and Luxembourg reduce the tax withheld from dividends in general to half the normal rate, and to 5% in the case of subsidiaries.

Although France reduces to 5% the rate on dividends from a local

[5]This was 50% or more of the foreign corporation's gross income derived during a prescribed 3-year period from certain U.S. sources. Sec. 861(a)(1)(C) and (a)(2)(B) I.R.C.

[6]This caveat was evidently overlooked by the U.S. negotiators when they were drafting provisions in the 1967 Treaty with France which authorizes the U.S. to tax certain dividends distributed by a French company to French citizens, residents and corporations. Treaty with France, Arts. 9(4)(b) and 13(1)(a). *See* Carroll, ABA INT'L LAWYER, July 1968, Vol. 2, No. 4, p. 135.

[7]O.E.C.D., Report of the Fiscal Committee, 1963, Draft Double Taxation Convention on Income and Capital, Art. 10.

subsidiary, it applies the 15% rate to the net income of a branch in France, deemed to be distributed to the U.S. parent. Pakistan agreed to reduce its supertax on outgoing dividends.[8]

Reciprocal Exemption of Interest in General

Four world-known economists reported to the League of Nations in 1923, that the imposition by a country of a tax on outgoing interest would discourage capital inflow. Their contention has been sustained in numerous treaties by the adoption of the principle of exemption, on condition of reciprocity, of interest paid by local borrowers to non-resident creditors, presupposing that the lender has no permanent establishment in the country of the debtor.

The United Kingdom, anticipating it would need all the capital its industries could borrow after World War II, agreed in its 1945 treaty with the U.S., that, in the absence of a permanent establishment belonging to the U.S. creditor, it would exempt interest on loans, at source, on condition of reciprocity. This example was followed in treaties with Ireland, the Netherlands, Denmark, Norway, Finland, Luxembourg, Greece, Germany and Austria. Canada deducts 15% at source. Certain countries withhold tax at rates reduced by the treaty, e.g., in Belgium to 15%, Switzerland 5%, Japan 10%, and France 10%.[9]

Reciprocal Exemption of Royalties

France insisted, in its treaties of 1932 and 1939 with the U.S.A., that the latter should exempt reciprocally royalities paid by publishers in the U.S.A. for the use of copyrights licensed by French authors, and this applied to patents as well. Since then, the flow of such income from France to the U.S.A. has become much greater than in the reverse direction, and in the 1967 convention, France prevailed upon Washington to agree to a withholding rate of 5%. [Art. 11(2)].

In 1942, Canada insisted on maintaining for patent royalties its withholding rate of 15%, but in a 1950 amendment agreed to exempt copyright royalties. (Art. XIII c). On the contrary, the United Kingdom, in its convention of 1945 with the U.S.A., was so anxious to facilitate the obtaining by British industry of new American technology developed dur-

[8]Carroll, ABA INT'L. LAWYER, July 1968, Vol. 2, No. 4, pp. 135-139.

[9]*See* Carroll, *op, cit. supra* note 4, October 1968, pp. 139-141. Belgium agrees, in Art. 11 of the U.S.-Belgian convention of July 9, 1970, to continue the 15% withholding rate subject to exemption for interest on commercial credits, inter-bank transactions and deposits.

ing and after World War II, that it agreed to exempt all royalties at source. Later the proviso was added that such income was not to be effectively connected with a local permanent establishment belonging to the licensor. (Art. VIII, as amended). The purpose was to recognize a license agreement with an unrelated licensee as not connected with a local sales office.

Britain's example in regard to exempting income from licensing was followed by Ireland, Denmark, the Netherlands, Belgium, Norway, Greece and Switzerland. Australia exempted copyright royalties but, like South Africa, still tries to tax patent royalties as ordinary income. Italy applies exemption, on condition of reciprocity, for the national tax but not for the additional percentages collected by local authorities.

In principle, exemption is granted reciprocally by Austria, Pakistan, Luxembourg and Germany. Japan withholds 10% reciprocally.[10]

Applicability of Treaties to Washington Congress Subjects Allocation to Affiliates and Permanent Establishments

As regards the allocation of income and expenses to affiliates abroad, the treaties embody the basic principle in Sec. 482 IRC, which authorizes the IRS to apply the test of dealing at arm's length to transactions when re-alllocating income (to prevent its diversion) from a subsidiary in one country to a parent corporation in another, or vice versa. This principle has been embodied in all the conventions to which the U.S.A. is a party. The same principle applies in dealings with a permanent establishment, which is taxable as if it were an independent entity engaged in the same or similar transactions under the same or similar conditions.

In the national report of the United States for the Washington Congress, the administrative practices of the IRS will be described. The practices of other countries in this regard will be outlined in their reports. The treaties envisage that the authorities will, in a given case, communicate with each other, and arrive at an allocation or apportionment so that the same income will not be taxed in both countries.[11]

Income Flowing to and from Offshore Funds

Offshore mutual funds or trusts are frequently organized in countries like

[10] *Op. cit. supra* note 4, October 1968, pp. 141-144.

[11] Minor variations in the treaty articles are described in *op. cit. supra* note 4, October 1968, pp. 144-150.

the Bahamas or Panama, which have no income tax, or do not tax income from foreign sources, and therefore have not concluded tax treaties.

The Netherlands Antilles seeks to attract foreign business and keep its rates low. It is a party to the treaty between the Netherlands and the U.S.A. by reason of the treaty having been extended to cover especially Curacao, where a number of investment companies have their seat. This subject is to be covered at the Washington Congress.

Propagation of Tax Treaties

IFA members have been fascinated by the way one treaty begets another. When U.S. Special Deputy Commissioner Eldon P. King was invited to attend the Fiscal Committee meeting in Geneva in 1938, at the instance of the American who was Chairman of the Committee, the latter introduced him to all the other members. One day, he took Mr. King and the Swedish member, Dr. C. de Kuylenstierna, to luncheon at La Perle du Lac on the shore of Lac Leman. The possibility of a tax treaty between Sweden and the USA was discussed and not long afterwards the Swedish member came to Washington where he and Mr. King followed more or less the general models, and negotiated the treaty in 1939.[12]

Over two decades later, the provisions of this convention were reflected in the conventions negotiated by Sweden with Argentina, signed September 3, 1962.[13] A similar treaty was signed with Brazil, September 17, 1965.[14] Then followed a convention between Sweden and Peru, signed September 17, 1966.[15]

Returning to the Regional Tax Conference in Mexico City, over which the author presided in 1940, and between sessions on the Mexico Model Convention, Mr. King and C. Fraser Elliott, KC, Canadian Deputy Minister for Internal Revenue, whom he had met at Geneva, conferred in the gardens of Chapultepec. They brought forth the first income tax convention between the U.S.A. and Canada.[16]

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[12]Income Tax Convention signed March 23, 1939, with accompanying protocol. Ratifications exchanged November 4, 1939, operative January 1, 1940. T.S. 958; 54 Stat. pt. 2, 1759.

[13]UN Dept. of Economy & Soc. Affairs, Int. Tax Agreements, Vol. IX, Part I, No. 87. Agreement between Argentina and Sweden for the Avoidance of Double Taxation.

[14]*Id.* Part 2, No. 140, Agreement between Brazil and Sweden for the Avoidance of Double Taxation.

[15]*Id.* Part 2, No. 217, Agreement between Peru and Sweden for the Avoidance of Double Taxation.

[16]Income tax convention, signed March 4, 1942, with accompanying protocol; Ratifications exchanged June 15, 1942, T.S. 989; 56 Stat. 915. See also supplementary convention signed June 12, 1950. Ratifications exchanged November 21, 1951, T.I.A.S. 2347; 2 U.S.T., pt 2, 2235. Supplementary convention signed August 8, 1956. Ratifications exchanged September 20, 1957, T.I.A.S. 3916, 8 U.S.T. 1619. Supplementary convention signed October 25, 1966. Ratifications exchanged December 20, 1967. T.I.A.S.

Negotiation of Treaty with the United Kingdom

Anticipating the need of a treaty to remove tax obstacles to the economic recovery of the United Kingdom after suffering the devastation of World War II, the British authorities invited Mr. King to come to London. There, in Somerset House, the head office of the Board of Inland Revenue, and with buzz "bombs bursting in air" they used the new treaty with Canada as a basis for working out the agreement between the U.S. and the United Kingdom with certain adaptations to particularities of the British income tax system.[17]

During an interlude in the negotiations with the British, Mr. King flew to South Africa and negotiated an agreement to fit the quite different system in South Africa from that of the U.S.A. It was signed on December 13, 1946.[18]

During his visit to Geneva in 1938, Mr. King had been introduced by the author to the members of the Fiscal Committee, including the heads of the tax administrations of France, Belgium, the Netherlands, Switzerland, Italy, etc. Problems had arisen vis-à-vis France which were not covered by the very limited convention negotiated in 1930, and the negotiation of a broader convention was undertaken by Mr. King and his colleagues in the Treasury and the Department of State.[19]

IFA had its revival Congress in The Hague, September 11-13, 1947, and this provided such a stimulus, that during the following winter the Dutch government sent to Washington a delegation which negotiated with Mr. King an income tax convention, signed April 29, 1948. This was extended to the Netherlands Antilles.[20]

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[17]Treaty with the United Kingdom on Double taxation, April 16, 1945, 60 STAT. 1377 (1945), T.I.A.S. No. 1546; Supplementary Protocol, May 25, 1954, (1955) 6 U.S.T. 37, T.I.A.S. No. 1546; Supplementary Protocol, May 25, 1954 (1955 6 UST 37, T.I.A.S. No. 3165, Supplementary Protocol, August 19, 1957 (1958)). 9 U.S.T.B29, T.I.A.S. No. 4124; Supplementary Protocol, March 17, 1966, (1966) 17 U.S.T. 1254, T.I.A.S. No. 6089.

[18]Income Tax Convention with the Union of South Africa, signed December 13, 1946, and supplementary protocol signed July 14, 1950. Ratifications exchanged July 15, 1952, T.I.A.S. 2510; 3 UST, pt. 3, 3821.

[19]Income Tax Convention with protocol signed at Paris, April 27, 1932. Ratifications exchanged April 9, 1935, effective January 1, 1936. T.S. No. 885, replaced by income tax convention, with accompanying protocol, signed July 25, 1939. Ratifications exchanged December 30, 1944, operative January 1, 1945. T.S. 988; 59 STAT., pt. 2 893. Income-estate tax convention, signed October 18, 1946, with supplementary protocol, signed May 17, 1948. Ratifications exchanged October 17, 1949. T.I.A.S. 1982; 64 STAT. pt. 3, B3. Income-estate-tax supplementary convention, signed June 22, 1956. Ratifications exchanged June 13, 1957. T.I.A.S. 3844; 8 U.S.T. 843. Tax convention with France, signed July 28, 1967. Ratifications exchanged July 11, 1968. T.I.A.S. 6518; 19 U.S.T. 5280.

[20]Income-tax convention with the Netherlands signed April 29, 1948. Ratifications exchanged December 1, 1948. T.I.A.S. 1855; 62 STAT. pt. 2, 1757. Income-tax supplementary protocol, signed June 15, 1955. Ratifications exchanged November 10, 1955. T.I.A.S. 3366; 6 U.S.T., pt. 3, 3696.

In the series of conventions with European countries which followed, it is of especial interest to note that on May 22, 1954[21] a general income tax convention was signed with Germany. Ever since the signing, in 1899, of the original convention between Prussia and Austria-Hungary, Germany has been a leader in promoting international tax law through treaties, and in the activities of IFA. One of the most active has been Dr. Wolfgang Mersmann, former German Director General of Federal taxes, and for many years President of the Federal Supreme Court of Taxation.

The German-US treaty in turn was reflected in the convention which Germany concluded with Argentina on July 13, 1966.[22] Since then Germany has undertaken negotiations with Brazil and Chile.

Shortly before signing the treaty with Germany, the United States had, on April 14, 1954, signed a treaty with Japan.[23] Not long after this series of negotiations between Japan and the United States, Japanese officials concluded an agreement with Brazil, signed January 24, 1967.[24]

The treaty with the United Kingdom contained a clause envisaging its extension to territorial possessions, and the United Kingdom made it applicable to twenty-one of its overseas territories, thus extending its application as between the U.S.A. and each of them.[25] However, after Trinidad-Tobago became independent, it wanted its own treaty with the U.S.A. One was signed January 9, 1970, and ratifications were exchanged December 30, 1970.[26]

Income-tax supplementary protocol, signed October 23, 1963, Ratifications exchanged, September 28, 1964. T.I.A.S. 5665; 15 U.S.T. 1900.

Income-tax supplementary protocol, signed December 30, 1965, Ratifications exchanged July 8, 1966. T.I.A.S. 6051; 17 U.S.T. 896.

[21]Income-tax convention, signed May 22, 1954. Ratifications exchanged December 20, 1954. T.I.A.S. 3133; 5 U.S.T. pt. 3, 2768. Income tax supplementary protocol signed September 17, 1965. Ratifications exchanged December 27, 1965. T.I.A.S. 5920, 16 U.S.T. 1875.

[22]UN International tax agreements, Vol. IX, part 2, No. 183. Agreement between Argentina and the Federal Republic of Germany for avoidance of Double Taxation.

[23]Income tax convention with Japan, with exchange of notes, signed April 16, 1954. Ratifications exchanged April 1, 1955. T.I.A.S. 3176; 6 U.S.T. 149. Income tax supplementary protocol, signed August 14, 1962. Ratifications exchanged May 6, 1965. T.I.A.S. 5798; 16 U.S.T. 697.

[24]UN Department of Economic and Social Affairs, International Tax Agreements, Vol. IX, part 2, No. 191. Convention between Japan and Brazil for the avoidance of Double Taxation of Income (signed January 24, 1967). This treaty could be taken as a model to encourage investment by nationals of the contracting States and offer to "spare" taxes to accomplish this result.

[25]Notification by the government of Great Britain and Northern Ireland to extend to certain British overseas territories. The application of the convention to taxes on income, as modified, signed in April 16, 1945 (notification received August 19, 1957), Ex. C, 85th Congress, 2d session, with Reservation. CCH Tax Treaties #8159.

[26]T.I.A.S.

U.S. Efforts to Conclude Treaties with Latin American Countries

Ever since participating in the League of Nations Regional Tax Conferences in Mexico in 1940 and 1943, Treasury officials have visited practically every country in Latin America to prevail upon their top officials to conclude tax treaties with the United States. They succeeded in negotiating a convention on classic lines with Honduras in 1956.[27] However, Honduras is said to have been disappointed that the treaty did not attract more American investments and denounced it in 1964, presumably in the hope of making a better arrangement; but none has been concluded.

After years of negotiations, the Treasury concluded a convention with Brazil. As a concession to a less developed country the treaty provided for a version of the 7% investment credit which was repealed by Congress. The Senate Committee on Foreign Relations recommended approval by the Senate but with major reservations, which rendered the treaty unacceptable to Brazil.[28]

Concessions Granted in Tax Treaties by Sweden, Germany and Japan

In the respective treaties of Sweden, Germany and Japan with Argentina, Brazil and/or Peru, these countries departed from the orthodox pattern of their connections with the United States, and agreed to certain provisions requested by the negotiators representing the less developed countries.[29]

Sweden led the way in 1962 by recognizing Argentina's basic principle of territoriality, that is to say, income from sources in Argentina and taxable therein would be exempt from taxation in Sweden. However, as an exception, Sweden could tax royalties paid by an Argentine licensee but would allow a credit for a tax withheld at source in Argentina, which was limited to 15%. Sweden would grant this credit even if Argentina reduced its rate to a lower level to attract the licensing of technology.[30]

[27]Treaty with Honduras on Double Taxations, signed June 25, 1956, T.I.A.S. 3766; 1 U.S.T. 219. Denounced as of January 1, 1967.

[28]S. Exec. Jour. 90th Congress, 1st sess. 462 (1967). *See also Hearings on Tax Conventions with Brazil, Canada and Trinidad and Tobago before the Senate Committee in Foreign Relations*, 90th Congress, 1st Sess. (1967).

[29]These conventions are discussed in detail in Carroll, *Germany, Japan and Sweden Show the United States How to Reach Tax Treaties with South American Countries*, The Geo. Wash. L. Rev., Vol. 38, No. 2, December 1969, pp. 199–214, referred to *infra* as "*op. cit.*"

[30]*Op. cit., supra*, note 29 at 204, 206.

In its 1965 treaty with Brazil, Sweden grants a credit for Brazilian taxes in language which seems to have been modelled on the U.S. provisions for crediting foreign taxes. A similar provision is found in the treaty with Peru.[31]

Having seen what the Swedish negotiators had done, the Germans, in the treaty of July 13, 1966, allowed a credit for an Argentine tax of 15% withheld from dividends, but exempted the German parent company on dividends received from shares representing 25% or more of the capital of the Argentine company. A credit is allowed also for 35% of the gross interest received. If the Argentine rate is reduced, then credit is granted for the lesser percentage. In the case of royalties, Germany includes the royalty in taxable income but allows a credit of 15% for the Argentine tax of 15%, even if it is reduced below that rate to attract the licensing of technology.[32]

In its treaty of 1967, Japan allows a credit for Brazilian taxes, including "taxes spared" but deemed to have been paid at the regular rate, even if the treaty applies a lower rate of 10% in dividends, interest or royalties. The credit for "taxes spared" applies to Brazilian taxes waived or reduced by Brazilian law to encourage investments, especially in the region of the Amazon and in Northern and Northeast Brazil.[33]

All the conventions embody the standard treaty clause that an office or agent will not be treated as a permanent establishment, if it is merely engaged in purchasing goods or merchandise for the enterprise in the other state. However, both Sweden and Germany agree to an exception in their treaties with Argentina, namely that the tax authorities may attribute a profit to a fixed place of business or an agent authorized to purchase products of agriculture or cattle breeding. Sweden consents to Peru's making a similar attribution for the purchase of fishing and mining products.[34]

It is said that the profit would be measured by what an independent enterprise would make.

Apparently, Japan made no such concession in its treaty with Brazil.

One of the German negotiators has said that the question of imputing a profit to an office or agent has not arisen, and the credit for taxes spared has caused no difficulties.

[31] *Op. cit.*, at 204.
[32] *Op. cit.*, at 204-205.
[33] *Op. cit.*, at 204-205.
[34] *Op. cit.*, at 206-207.

Recent U.S. Tax Conventions

At the end of 1970, the Senate and the Department of State took steps to bring into force a number of conventions and protocols that had been negotiated during 1969 or 1970. The report of the *Committee on Foreign Relations, dated November 23, 1970,*[35] declared that, having considered the tax conventions with Belgium, Finland, Trinidad and Tobago, and the estate tax convention with the Netherlands, the Committee reported favorably thereon, with a reservation applicable to the Trinidad and Tobago convention, *infra.*

Protocol with France Allowing Credit

On December 15, 1970, a protocol to the 1967 double taxation convention with France was referred to the Committee on Foreign Relations and published. U.S. holders of shares in French companies are interested in this protocol, because it amends Article 9 of the 1967 convention with France, to assure them of the benefit of a French credit for "avoir fiscal." This credit was inaugurated under French law in 1965 for the benefit of residents of France. It allowed them a credit equal to one-half the French corporate income tax (50%) paid with respect to profits out of which dividends were distributed. The protocol of 1970 would require France to extend to United States portfolio investors a credit of the kind mentioned.

The intended beneficiaries are (a) U.S. resident individuals, (b) U.S. corporations owning less than 10% of the shares of the paying French corporation, and (c) certain U.S.-regulated investment companies. The eligible U.S shareholder is deemed to have paid half the profits tax of 50% charged to the French company. This company is deemed to have paid a tax of 25%, and to have withheld the other 25% on behalf of the French government from the dividends distributed to the shareholder. The French resident shareholder includes this portion in his taxable income and credits it against his personal tax liability. If the amount credited exceeds the tax due, he receives a refund. This protocol does not apply to dividends between related companies, when the recipient owns 10% or more of the shares of the French corporation. In that case, the U.S. parent is allowed a credit in respect of the French company tax under sec. 902 I.R.C.

Revised Convention with Belgium

The tax convention with Belgium, signed July 9, 1970[36] replaces the

[35]Tax conventions with Belgium, Finland and Trinidad and Tobago, and estate tax convention with the Netherlands, 91st Cong. 2nd Sess., Senate, Executive Report No. 91-24 to accompany Ex. D. E.I., 91-2 and Ex.G. 91-1.

[36]1st Cong. 2d Sess., Senate, Executive I.

original convention of October 28, 1948, relating to the avoidance of double taxation with respect to taxes on income, as modified; it follows, as closely as policy and technical considerations permit, the model draft convention published in 1963 by the OECD. In substance it is similar to recent revisions of the convention with France, Germany and the United Kingdom. The new treaty retains the limit of 15% on the tax withheld from dividends, and also for interest in general, but exempts interest arising from commercial credits or on interbank transactions. For royalties the exemption from tax at source, provided in the existing convention, is continued in the new treaty.

Revised Convention with Finland

The convention with Finland, signed MARCH 6, 1970[37] is an amended text of the original convention of March 3, 1952. The revision takes into account changes in the tax laws of both countries. It provides, *inter alia,* a rate of 5% for dividends received by a U.S. parent corporation from 10%-owned subsidiaries, in contrast to the present test of 95%. From portfolio dividends 15% is withheld at source. The exemption at source for artistic royalties is extended to industrial royalties.

Convention with Trinidad and Tobago

In view of what has been said *infra* about treaties with less developed countries, the new convention with Trinidad and Tobago is the latest, and only effective, expression of the U.S. Treasury policy on this subject. This treaty was signed at Port of Spain on January 9, 1970.[38]

This convention reflects, in general, the conventions with France and the Netherlands, but contains provisions intended to take into account the situation of Trinidad and Tobago as a developing country. For example, Trinidad and Tobago reduces its withholding rates on direct investment income to a level which will be covered by the limit (48%) on the credit for foreign taxes in the case of a U.S. corporation. The reduced Trinidad and Tobago rates are 25% on portfolio dividends, 10% on direct-investment dividends, and 15% on interest. On royalties, the rate is limited reciprocally to 15%. In order to discourage investments by residents of Trinidad and Tobago in the U.S., this country continues to apply its rate of 30%.

The convention contains a novel provision (Art. 7) intended to remove a tax barrier to the flow of technology in a case in which a resident of one of the countries transfers patents or similar property rights, technical in-

[37] 91st Cong. 2d Sess., Senate, Executive E.
[38] 91st Cong. 2d Sess., Senate Executive D.

formation and certain ancillary services to a corporation of the other country in return for stock. Under the treaty, the taxes of both countries would be deferred until the stock is disposed of by the company which pays for it by transferring the patents, or other property.

According to the report on this convention,[39] the Committee on Foreign Relations reported it favorably, but with a reservation stating that "the government of the United States does not accept Article 7 of the convention relating to tax deferral."

The report notes that this provision, which is not found in any other U.S. treaty, is designed to provide a tax incentive for increasing the flow of technology from the United States to Trinidad and Tobago.

The Foreign Relations Committee says that this reservation, which has the approval of the Treasury Department, was accepted by the Committee because "it does not feel that the times and circumstances are appropriate for encouraging private American investments abroad."

Nevertheless, the Committee hopes to explore further with the Executive Branch, the feasibility of including incentives to American investors in tax treaties with less developed countries.

The report adds that the foregoing statement does have the effect of putting the administration on notice "that such a concept will not be approved until our domestic and international economic and political situations show a marked improvement."

Estate Tax Convention with the Netherlands

As business abroad has to be carried out through individuals who reside abroad, IFA is inevitably interested also in treaties to prevent the double imposition of death taxes on property in one country belonging to an individual who dies while domiciled in another. The estate tax convention with the Netherlands, signed October 13, 1969,[40] differs from the twelve other estate-tax conventions currently in force. It is patterned after the convention on estates and inheritances published in 1966 by the OECD. The eighteen articles deal with such matters as the tax treatment of immovable property and property forming part of a permanent establishment, taxation on the basis of domicile and citizenship, and credits for taxes imposed by the other country.

IFA Abreast of Developments in International Tax Law

This brief summary shows IFA's concern in the ever expanding network

[39] 91st Cong. 2d Sess., Senate Executive Report No. 91-24.
[40] 91st Cong. 1st Sess., Senate Executive G.

of treaties to prevent international double taxation, in the beginning as between primarily developed countries and today as between them and the developing countries. According to information obtained from the Secretary of the Ad Hoc group on tax treaties between developed and developing countries, over 600 conventions and supplementary and amendatory conventions and protocols have been counted by the United Nations and the number is growing by arithmetical progression.

The officials who have used the OECD model convention of 1963 in negotiations have already sought to remodel it in their own image when negotiating a treaty based thereon. The language in the latest conventions ratified by the United States shows the evolution from the simple phraseology in the first treaty written largely by the man who became the President of IFA, to the more complex draftsmanship of the top treasury officials of today who are negotiating tax treaties and by coincidence are members of IFA.

These members include, *inter alia,* the Assistant Secretary of the Treasury in charge of Tax Policy, Edwin S. Cohen, and the Director of International Tax Affairs, who at the same time is President of the Tax Committee of the OECD.

In short, as a renowned professor, Gürffre de Lapradelle of the University of Paris Law School, once said: "International Law is in a state of perpetual evolution. This is especially true of international tax law. In order to keep abreast of its development IFA's members must be diligent."