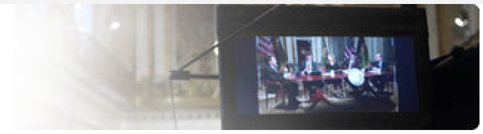

Opening Statement of International Tax Counsel Manal Corwin before the Senate Committee on Foreign Relations

11/10/2009

TG-402

Chairman Kerry, Ranking Member Lugar, and distinguished Members of the Committee, I appreciate the opportunity to appear today to recommend, on behalf of the Administration, favorable action on three tax treaties pending before this Committee. We appreciate the Committee's interest in these treaties and in the U.S. tax treaty network overall.

This Administration is committed to eliminating barriers to cross-border trade and investment, and tax treaties are the primary means for eliminating tax barriers to such trade and investment. Tax treaties provide greater certainty to taxpayers regarding their potential liability to tax in foreign jurisdictions; they allocate taxing rights between the two jurisdictions and include other provisions that reduce the risk of double taxation, including provisions that reduce gross-basis withholding taxes. Tax treaties also ensure that taxpayers are not subject to discriminatory taxation in the foreign jurisdiction.

This Administration is also committed to preventing tax evasion, and our tax treaties play an important role in this area as well. A key element of U.S. tax treaties is exchange of information between tax authorities. Under tax treaties, one country may request from the other such information as may be relevant for the proper administration of the first country's tax laws. Because access to information from other countries is critically important to the full and fair enforcement of U.S. tax laws, information exchange is a top priority for the United States in its tax treaty program.

A tax treaty reflects a balance of benefits that is agreed to when the treaty is negotiated. In some cases, changes in law or policy in one or both of the treaty partners make the partners more willing to increase the benefits beyond those provided by the original treaty; in these cases, negotiation of a revised treaty may be very beneficial. In other cases, developments in one or both countries, or international developments more generally, may make it desirable to revisit a treaty to prevent exploitation of treaty provisions and eliminate unintended and inappropriate consequences in the application of the treaty; in these cases, it may be expedient to modify the agreement. Both in setting our overall negotiation priorities and in negotiating individual treaties, our focus is on ensuring that our tax treaty network fulfills its goals of facilitating cross border trade and investment and preventing fiscal evasion.

The treaties before the Committee today with France, Malta and New Zealand serve to further the goals of our tax treaty network. The treaties with France and New Zealand would modify existing tax treaty relationships, to increase benefits in some instances and to eliminate inappropriate benefits in others. The tax treaty with Malta would re-establish a tax treaty relationship between our two countries that was interrupted when the United States terminated a prior tax treaty with Malta signed in 1980. We urge the Committee and the Senate to take prompt and favorable action on all of these agreements.

Before talking about the pending treaties in more detail, I would like to discuss some more general tax treaty matters.

Purposes and Benefits of Tax Treaties

Tax treaties set out clear ground rules that govern tax matters relating to trade and investment between the two countries.

One of the primary functions of tax treaties is to provide certainty to taxpayers regarding the threshold question with respect to international taxation: whether a taxpayer's cross-border activities will subject it to taxation by two or more countries. Tax treaties answer this question by establishing the minimum level of economic activity that must be engaged in within a country by a resident of the other before the first country may tax any resulting business profits. In general terms, tax treaties provide that if branch operations in a foreign country have sufficient substance and continuity, the country where those activities occur will have primary (but not exclusive) jurisdiction to tax. In other cases, where the operations in the foreign country are relatively minor, the home country retains the sole jurisdiction to tax.

Another primary function is relief of double taxation. Tax treaties protect taxpayers from potential double taxation primarily through the allocation of taxing rights between the two countries. This allocation takes several forms. First, the treaty has a mechanism for resolving the issue of residence in the case of a taxpayer that otherwise would be considered to be a resident of both countries. Second, with respect to each category of income, the treaty assigns primary taxing rights to one country, usually (but not always) the country in which the income arises (the "source" country), and the residual right to tax to the other country, usually (but not always) the country of residence of the taxpayer (the "residence" country). Third, the treaty provides rules for determining the country of source for each category of income. Finally, the treaty establishes the obligation of the residence country to eliminate double taxation that otherwise would arise from the exercise of concurrent taxing jurisdiction by the two countries.

In addition to reducing potential double taxation, tax treaties also reduce potential "excessive" taxation by reducing withholding taxes that are imposed at source. Under U.S. law, payments to non-U.S. persons of dividends and royalties as well as certain payments of interest are subject to withholding tax equal to 30 percent of the gross amount paid. Most of our trading partners impose similar levels of withholding tax on these types of income. This tax is imposed on a gross, rather than net, amount. Because the withholding tax does not take into account expenses incurred in generating the income, the taxpayer that bears the burden of withholding tax frequently will be subject to an effective rate of tax that is significantly higher than the tax rate that would be applicable to net income in either the source or residence country. The taxpayer may be viewed, therefore, as suffering excessive taxation. Tax treaties alleviate this burden by setting maximum levels for the withholding tax that the treaty partners may impose on these types of income or by providing for exclusive residence-country taxation of such income through the elimination of source-country withholding tax. Because of the excessive taxation that withholding taxes can represent, the United States seeks to include in tax treaties provisions that substantially reduce or eliminate source-country withholding taxes.

As a complement to these substantive rules regarding allocation of taxing rights, tax treaties provide a mechanism for dealing with disputes between the countries regarding the treaties, including questions regarding the proper application of the treaties that arise after the treaty enters into force. To resolve disputes, designated tax authorities of the two governments – known as the "competent authorities" in tax treaty parlance – are to consult and to endeavor to reach agreement. Under many such agreements, the competent authorities agree to allocate a taxpayer's income between the two taxing jurisdictions on a consistent basis, thereby preventing the double taxation that might otherwise result. The U.S. competent authority under our tax treaties is the Secretary of the Treasury or his delegate. That function has been delegated to the Deputy Commissioner (International) of the Large and Mid-Size Business Division of the Internal Revenue Service.

Tax treaties also include provisions intended to ensure that cross-border investors do not suffer discrimination in the application of the tax laws of the other country. This is similar to a basic investor protection provided in other types of agreements, but the non-discrimination provisions of tax treaties are specifically tailored to tax matters and, therefore, are the most effective means of addressing potential discrimination in the tax context. The relevant tax treaty provisions explicitly prohibit types of discriminatory measures that once were common in some tax systems. At the same time, tax treaties clarify the manner in which possible discrimination is to be tested in the tax context.

In addition to these core provisions, tax treaties include provisions dealing with more specialized situations, such as rules coordinating the pension rules of the tax systems of the two countries or addressing the treatment of Social Security benefits and alimony and child-support payments in the cross-border context (the Social Security Administration separately negotiates and administers bilateral totalization agreements). These provisions are becoming increasingly important as more individuals move between countries or otherwise are engaged in cross-border activities. While these matters may not involve substantial tax revenue from the perspective of the two governments, rules providing clear and appropriate treatment are very important to the affected taxpayers.

Tax treaties also include provisions related to tax administration. A key element of U.S. tax treaties is the provision addressing the exchange of information between the tax authorities. Under tax treaties, the competent authority of one country may request from the other competent authority such information as may be relevant for the proper administration of the first country's tax laws; the information provided pursuant to the request is subject to the strict confidentiality protections that apply to taxpayer information. Because access to information from other countries is critically important to the full and fair enforcement of the U.S. tax laws, information exchange is a priority for the United States in its tax treaty program. If a country has bank secrecy rules that would operate to prevent or seriously inhibit the appropriate exchange of information under a tax treaty, we will not enter into a new tax treaty relationship with that country. Indeed, the need for appropriate information exchange provisions is one of the treaty matters that we consider non-negotiable.

Tax Treaty Negotiating Priorities and Process

The United States has a network of 59 income tax treaties covering 67 countries. This network covers the vast majority of foreign trade and investment of U.S. businesses and investors. In establishing our negotiating priorities, our primary objective is the conclusion of tax treaties that will provide the greatest benefit to the United States and to U.S. taxpayers. We communicate regularly with the U.S. business community and the Internal Revenue Service, seeking their input regarding the areas in which treaty network expansion and improvement efforts should be focused and seeking information regarding practical problems encountered under particular treaties and particular tax regimes.

The primary constraint on the size of our tax treaty network may be the complexity of the negotiations themselves. Ensuring that the various functions to be performed by tax treaties are all properly taken into account makes the negotiation process exacting and time consuming.

Numerous features of a country's particular tax legislation and its interaction with U.S. domestic tax rules are considered in negotiating a tax treaty. Examples include whether the country eliminates double taxation through an exemption system or a credit system, the country's treatment of partnerships and other transparent entities, and how the country taxes contributions to pension funds, earnings of the funds, and distributions from the funds.

Moreover, a country's fundamental tax policy choices are reflected not only in its tax legislation but also in its tax treaty positions. These choices differ significantly from country to country, with substantial variation even across countries that seem to have quite similar economic profiles. A treaty negotiation must take into account all of these aspects of the particular treaty partner's tax system and treaty policies to arrive at an agreement that accomplishes the United States' tax treaty objectives.

Obtaining the agreement of our treaty partners on provisions of importance to the United States sometimes requires concessions on our part. Similarly, the other country sometimes must make concessions to obtain our agreement on matters that are critical to it. Each tax treaty that we present to the Senate represents not only the best deal that we believe can be achieved with the particular country, but also constitutes an agreement that we believe is in the best interests of the United States.

In some situations, the right result may be no tax treaty at all. Prospective treaty partners must evidence a clear understanding of what their obligations would be under the treaty, especially those with respect to information exchange, and must demonstrate that they would be able to fulfill those obligations. Sometimes a tax treaty may not be appropriate because a potential treaty partner is unable to do so.

In other cases, a tax treaty may be inappropriate because the potential treaty partner is not willing to agree to particular treaty provisions that are needed to address real tax problems that have been identified by U.S. businesses operating there. If the potential treaty partner is unwilling to provide meaningful benefits in a tax treaty, investors would find no relief, and accordingly there would be no merit to entering into such an agreement. The Treasury Department would not enter into a tax treaty that did not provide benefits to investors or which could be construed as an indication to future potential treaty partners that we would settle for a tax treaty with inferior terms.

Sometimes a potential treaty partner insists on provisions the United States will not agree to, such as providing a U.S. tax credit for investment in the foreign country (so-called "tax sparing"). With other countries there simply may not be the type of cross-border tax issues that are best resolved by treaty. For example, if a country does not impose significant income taxes, there is little possibility of double taxation of cross-border income, and an agreement that focuses exclusively on the exchange of tax information (so called "tax information exchange agreements" or TIEAs) may be the most appropriate agreement.

A high priority for improving our overall treaty network is continued focus on prevention of "treaty shopping." The U.S. commitment to including comprehensive limitation on benefits provisions is one of the keys to improving our overall treaty network. Our tax treaties are intended to provide benefits to residents of the United States and residents of the particular treaty partner on a reciprocal basis. The reductions in source-country taxes agreed to in a particular treaty mean that U.S. persons pay less tax to that country on income from their investments there and residents of that country pay less U.S. tax on income from their investments in the United States. Those reductions and benefits are not intended to flow to residents of a third country. If third-country residents are able to exploit one of our tax treaties to secure reductions in U.S. tax, such as through the use of an entity resident in a treaty country that merely holds passive U.S. assets, the benefits would flow only in one direction, as third-country residents would enjoy U.S. tax reductions for their U.S. investments, but U.S. residents would not enjoy reciprocal tax reductions for their investments in that third country. Moreover, such third-country residents may be securing benefits that are not appropriate in the context of the interaction between their home country's tax systems and policies and those of the United States. This use of tax treaties is not consistent with the balance of the deal negotiated in the underlying tax treaty. Preventing this exploitation of our tax treaties is critical to ensuring that the third country will sit down at the table with us to negotiate on a reciprocal basis, so we can secure for U.S. persons the benefits of reductions in source-country tax on their investments in that country.

Consideration of Arbitration

Tax treaties cannot facilitate cross-border investment and provide a more stable investment environment unless the treaty is effectively implemented by the tax administrations of the two countries. Under our tax treaties, when a U.S. taxpayer becomes concerned about implementation of the treaty, the taxpayer can bring the matter to the U.S. competent authority who will seek to resolve the matter with the competent authority of the treaty partner. The competent authorities will work cooperatively to resolve genuine disputes as to the appropriate application of the treaty.

The U.S. competent authority has a good track record in resolving disputes. Even in the most cooperative bilateral relationships, however, there will be instances in which the competent authorities will not be able to reach a timely and satisfactory resolution. Moreover, as the number and complexity of cross-border transactions increases, so does the number and complexity of cross-border tax disputes. Accordingly, we have considered ways to equip the U.S. competent authority with additional tools to resolve disputes promptly, including the possible use of arbitration in the competent authority mutual agreement process.

The first U.S. tax agreement that contemplated arbitration was the U.S.-Germany income tax treaty signed in 1989. Tax treaties with some other countries, including Mexico and the Netherlands, incorporate authority for establishing voluntary binding arbitration procedures based on the provision in the prior U.S.-Germany treaty (although these provisions have never been implemented). Although we believe that the presence of these voluntary arbitration provisions may have provided some limited incentive to reaching mutual agreements, it has become clear that the ability to enter into voluntary arbitration does not always provide sufficient incentive to resolve problem cases in a timely fashion.

Over the past few years, we have carefully considered and studied various types of mandatory arbitration procedures that could be used as part of the competent authority mutual agreement process. In particular, we examined the experience of countries that adopted mandatory binding arbitration provisions with respect to tax matters. Many of them report that the prospect of impending mandatory arbitration creates a significant incentive to compromise before commencement of the process. Based on our review of the U.S. experience with arbitration in other areas of the law, the success of other countries with arbitration in the tax area, and the overwhelming support of the business community, we concluded that mandatory binding arbitration as the final step in the competent authority process can be an effective and appropriate tool to facilitate mutual agreement under U.S. tax treaties.

One of the treaties before the Committee, the Protocol with France, includes a type of mandatory arbitration provision that in general terms is similar to provisions in our current treaties with Canada, Germany and Belgium, which this Committee and the Senate have approved over the last three years.

In the typical competent authority mutual agreement process, a U.S. taxpayer presents its problem to the U.S. competent authority and participates in formulating the position the U.S. competent authority will take in discussions with the treaty partner. Under the arbitration provision proposed in the France protocol, as in the similar provisions that are now part of our treaties with Canada, Germany and Belgium, if the competent authorities cannot resolve the issue within two years, the competent authorities must present the issue to an arbitration board for resolution, unless both competent authorities agree that the case is not suitable for arbitration. The arbitration board must resolve the issue by choosing the position of one of the competent authorities. That position is adopted as the agreement of the competent authorities and is treated like any other mutual agreement (*i.e.*, one that has been negotiated by the competent authorities) under the treaty.

Because the arbitration board can only choose between the positions of each competent authority, the expectation is that the differences between the positions of the competent authorities will tend to narrow as the case moves closer to arbitration. In fact, if the arbitration provision is successful, difficult issues will be resolved without resort to arbitration. Thus, it is our expectation that these arbitration provisions will be rarely utilized, but that their presence will encourage the competent authorities to take approaches to their negotiations that result in mutually agreeable conclusions in the first place.

The arbitration process proposed in the agreement with France, consistent with its predecessors, is mandatory and binding with respect to the competent authorities. However, consistent with the negotiation process under the mutual agreement procedure generally, the taxpayer can terminate the arbitration at any time by withdrawing its request for competent authority assistance. Moreover, the taxpayer retains the right to litigate the matter (in the United States or the treaty partner) in lieu of accepting the result of the arbitration, just as it would be entitled to litigate in lieu of accepting the result of a negotiation under the mutual agreement procedure.

In negotiating the arbitration rule in the proposed Protocol with France, we took into account concerns expressed by this Committee over certain aspects of the arbitration rules with Canada, Germany and Belgium. Accordingly, the proposed arbitration rule with France differs from its predecessors in three key respects. First, recognizing the Committee's instructions in its report on the Canada protocol that future arbitration rules should provide a mechanism for taxpayer input in the arbitration process, the proposed rule with France allows the taxpayers who presented the original case that is subjected to arbitration to submit a Position Paper directly to the arbitration panel. Second, the rule on the proposed France Protocol disallows a competent authority from appointing an employee from its own tax administration to the arbitration board. Finally, the rule in the proposed France Protocol does not prescribe a hierarchy of legal authorities that the arbitration panel will use in making its decision. Thus, customary international law rules on treaty interpretation will apply. The new protocol amending our tax treaty with Switzerland, signed in September 2009, also contains an arbitration rule that is substantially the same as the rule in the proposed France Protocol. The Administration hopes to transmit the Switzerland protocol to the Senate for its advice and consent as soon as possible.

Arbitration is a growing and developing field, and there are many forms of arbitration from which to choose. We intend to continue to study other arbitration provisions and to monitor the performance of the provisions in the agreements with Canada, Belgium and Germany, as well as the performance of the provision in the agreement with France, if ratified. As requested by the Senate in its approval of the protocol with Canada in 2008, the Internal Revenue Service has published the administrative procedures necessary to implement the arbitration rules with Germany and Belgium, although to date no tax disputes with either country has been submitted to arbitration. The development of arbitration procedures are still under discussion with the Canadian tax authorities.

We look forward to continuing to work with the Committee to make arbitration an effective tool in promoting the fair and expeditious resolution of treaty disputes. The Committee's comments made with respect to the arbitration provisions with Canada, Germany and Belgium have been very helpful and will continue to inform future negotiations of arbitration provisions.

Discussion of Proposed Treaties

I now would like to discuss the three tax treaties that have been transmitted for the Senate's consideration. We have submitted a Technical Explanation of each treaty that contains detailed discussions of the provisions of each treaty. These Technical Explanations serve as the Treasury Department's official guide to each tax treaty.

France

The proposed Protocol with France was signed in Paris on January 13, 2009, and is the second protocol of amendment to the current tax Convention with France, signed in 1994. The most significant provisions in this agreement relate to the taxation of dividends and royalties, the adoption of mandatory arbitration to facilitate the resolution of disputes between the U.S. and French revenue authorities, and provisions to prevent treaty abuse and provide for full exchange of information for tax purposes. The Protocol also makes a number of necessary updates to the current Convention to better reflect French and U.S. domestic law.

The proposed Protocol makes a number of changes to the dividend article of the current Convention. The proposed Protocol eliminates the source-country withholding tax on many intercompany dividends. In general, a company receiving a dividend must have a substantial interest in the distributing corporation for a 12-month period and meet special limitation on benefits provisions to qualify for the exemption from withholding tax. The proposed Protocol also updates the dividend article to incorporate policies reflected in the U.S. Model provision, such as those regarding regulated investment companies (RICs) and real estate investment trusts (REITs).

The proposed Protocol makes a significant change to the royalty article of the current Convention. The current Convention allows the source country to withhold on royalty payments to residents of the other treaty partner with respect to certain types of property, but limits the withholding rate to a maximum of five percent. The proposed Protocol eliminates source-country withholding on all royalty payments, bringing the Convention in line with the U.S. Model treaty.

The proposed Protocol makes a number of changes to the limitation on benefits article of the current Convention. It tightens the limitation on benefits rules applicable to publicly-traded companies to ensure a closer nexus between the company and its residence country through regional trading of its shares or local management and control. The proposed Protocol further tightens the limitation on benefits provision by including a so-called "triangular provision" adopted in many U.S. tax treaties. The rule is designed to prevent the use of structures including third-country branches to avoid both source- and residence-country taxation. Under the provision, the United States need not allow full treaty benefits to a French enterprise with respect to certain income attributable to a permanent establishment of the French enterprise located in a third country if the income is not subject to a sufficient combined level of tax in both France and the third country.

The proposed Protocol updates the provision in the current Convention that preserves the U.S. right to tax certain former citizens also to cover certain former long-term residents to reflect changes in U.S. law.

As previously noted, the proposed Protocol provides for mandatory arbitration of certain cases that have not been resolved by the competent authority within a specified period, generally two years from the commencement of the case. A Memorandum of Understanding accompanying the Protocol sets forth rules and procedures for arbitration. The arbitration board must deliver a determination within six months of the appointment of the chair of the arbitration board, and the determination must either be the proposed resolution submitted by the United States or the proposed resolution submitted by France. The board's determination has no precedential value and that the board shall not provide a rationale for its determination. As mentioned above, in response to concerns expressed by the Senate in the approval of prior agreements, the arbitration rule in the proposed Protocol differs from earlier arbitration provisions in some key respects. First, the proposed Protocol permits the concerned taxpayers to summit written Position Papers to the arbitration board. Second, under the proposed Protocol, the competent authority of a Contracting State may not appoint an employee of its tax administration to be a member of the arbitration board. Finally, the proposed protocol does not prescribe a hierarchy of legal authorities to which the arbitration board must adhere.

The proposed Protocol provides that the United States and France shall notify each other in writing, through diplomatic channels, when their respective constitutional and statutory requirements for entry into force of the proposed Protocol have been satisfied. The proposed Protocol will enter into force upon the date of receipt of the later of such notifications. For taxes withheld at source, it will have effect for amounts paid or credited on or after the first day of the January of the year in which the proposed Protocol enters into force. With respect to other taxes, the proposed Protocol will generally have effect for taxable years that begin on or after the first day of January next following the date on which the proposed Protocol enters into force.

Malta

The proposed income tax Convention and accompanying exchange of notes with Malta signed in Valletta on August 8 2008 re-establishes a previous tax treaty relationship between Malta and the United States. The proposed Convention is generally consistent with the current U.S. Model income tax treaty and with treaties that the United States has with other countries, while incorporating special rules to take into account special features of Malta's domestic tax law.

Under the proposed Convention, the United States may impose withholding taxes on cross-border portfolio dividend payments at a maximum rate of 15 percent. When the beneficial owner of the dividend is a company that directly owns at least 10 percent of the stock of the company paying the dividend, the United States may impose withholding tax at a maximum rate of 5 percent. The proposed Convention also incorporates rules provided in the U.S. Model tax treaty for certain classes of investment income. For example, dividends paid by RICs and REITs are subject to special rules to prevent the use of these entities to transform what is otherwise higher-taxed income into lower-taxed income.

The proposed Convention generally limits withholding taxes on cross-border interest and royalty payments to a maximum rate of 10 percent. The interest article of the proposed Convention also contains the U.S. Model rules regarding contingent interest and REMICs.

The proposed Convention limits the taxation by one country of the business profits of a resident of the other country. The source country's right to tax such profits is generally limited to cases in which the profits are attributable to a permanent establishment located in that country.

Consistent with current U.S. tax treaty policy, the proposed Convention includes a comprehensive limitation on benefits article, which takes into account unique features of Malta's tax system and is designed to deny treaty shoppers the benefits of the Convention. The proposed Convention provides for non-discriminatory treatment by one country to residents and nationals of the other country. In addition, the proposed Convention provides for the full exchange between the tax authorities of each country of information relevant to carrying out the provisions of the agreement or the domestic tax laws of either country . This will facilitate the enforcement of U.S. domestic tax rules. The proposed Convention provides that information exchanged pursuant to the Convention may, with the written consent of the country providing the information, be used for certain non-tax purposes as permitted under the provisions of an existing mutual legal assistance treaty between the two countries that allows for the exchange of tax information.

The proposed Convention provides that the United States and Malta shall exchange instruments of ratification when their respective applicable procedures for approval of the proposed Convention. The proposed Convention will enter into force upon the exchange of instruments of ratification. It will have effect, with respect to taxes withheld at source, for amounts paid or credited on or after the first day of the second month next following the date on which the proposed Convention enters into force and, with respect to other taxes, for taxable years beginning on or after the first day of January in the year following the date upon which the proposed Convention enters into force.

New Zealand

The proposed Protocol with New Zealand was signed in Washington on December 1, 2008, and amends the current tax Convention with New Zealand, which entered into force in 1983. The most significant provisions in this agreement relate to dividends, interest, royalties, taxation of income from personal services, anti-abuse provisions, and exchange of information for tax purposes. The proposed Protocol deletes the current Convention's denial of treaty benefits to certain categories of U.S. citizens. The Protocol also makes a number of necessary updates to the current Convention to better reflect New Zealand and U.S. domestic law.

The proposed Protocol makes a number of changes to the dividend article of the current Convention. The proposed Protocol eliminates the source-country withholding tax on many intercompany dividends. In general, a company receiving a dividend must have a substantial interest in the distributing corporation for a 12-month period and meet special limitation on benefits provisions to qualify for the exemption from withholding tax. The proposed Protocol also updates the dividend article to incorporate policies reflected in the U.S. Model provision, such as those regarding dividends paid by RICs and REITs.

The proposed Protocol amends the interest article of the current Convention. The current Convention allows the source country to withhold on interest payments to unrelated banks and certain financial enterprises at a maximum of 10 percent. The proposed Protocol eliminates source-country withholding on these payments, provided, in the case of New Zealand, that the payer of the interest has paid New Zealand's "approved issuer levy" with respect to the interest. Moreover, the proposed Protocol secures the elimination of taxation by New Zealand on interest payments to unrelated U.S. banks and financial enterprises even if New Zealand changes the approved issuer levy regime in the future.

The proposed Protocol makes significant changes to the royalty article of the current Convention. The current Convention allows the source country to withhold on royalty payments with respect to certain types of property to residents of the other treaty partner, but limits the withholding rate to a maximum of ten percent. The proposed Protocol lowers that maximum withholding rate on royalties to five percent. Additionally, the proposed Protocol amends current Convention's definition royalties by excluding from the definition payments for the rental of equipment and other tangible personal property. As a result, these rental payments will be subject to the same tax treatment as business income. These changes will bring the current tax Convention into closer alignment with U.S. Model tax treaty policy.

The proposed Protocol makes important changes to the taxation of individuals providing personal services. Under the current Convention, income from independent personal services (such as accounting, legal or consultancy services) may be taxed by the country in which the services are performed if the individual providing the services is present in that country for a period of 183 days or more. The proposed Protocol replaces this taxing right based on days of presence with the U.S. Model approach, which allows the country where the services are performed to tax the income only if the service provider has a fixed place of business in that country.

The proposed Protocol makes changes to the scope of benefits of the current Convention available to U.S. citizens. Under the current Convention, treaty benefits are only available to U.S. citizens who are also resident in the United States. The proposed Protocol eliminates the residency requirement and makes all U.S. citizens, wherever resident, eligible for treaty benefits. This broader application, which is consistent with the U.S. Model tax treaty, is appropriate policy, because all U.S. citizens are subject to tax by the United States on their worldwide income (and thus deserving of the benefits of U.S. tax treaties) regardless of their place of residence.

The proposed Protocol replaces the limitation on benefits article of the current Convention with a provision that closely tracks the U.S. Model rule. It tightens the limitation on benefits rules applicable to publicly-traded companies to ensure a closer nexus between the company and its residence country through trading of its shares on a local stock exchange or through local management and control. The proposed Protocol further tightens the limitation on benefits provision by including a so-called "triangular provision" adopted in many U.S. treaties. The rule is designed to prevent the use of structures including third-country branches to avoid both source- and residence-country taxation. Under the provision, the United States need not allow full treaty benefits to a New Zealand enterprise with respect to certain income attributable to a permanent establishment of the New Zealand enterprise located in a third country if the income is not subject to a sufficient combined level of tax in both New Zealand and the third country.

The proposed Protocol includes other anti-abuse rules. It extends the provision in the current Convention that preserves the U.S. right to tax certain former citizens also to cover certain former long-term residents, and updates the provision to reflect changes in U.S. law. The proposed Protocol conforms the interest article in the current Convention to the U.S. Model treaty by including special contingent interest and real estate mortgage investment conduit exceptions to the elimination of withholding tax on interest payments.

The proposed Protocol includes several other important administrative and technical amendments. Significantly, it updates the exchange of information provisions to specify the obligation to obtain and provide information held by financial institutions, and to otherwise reflect U.S. Model standards in this area.

The proposed Protocol provides that the United States and New Zealand shall notify each other in writing, through diplomatic channels, when their respective applicable procedures for ratification have been satisfied. The proposed Protocol will enter into force upon the date of the later of the required notifications. For taxes withheld at source, the proposed Protocol will have effect on the first day of the second month following the date of entry into force. With respect to other taxes, the Protocol will have effect in the United States for taxable periods starting on or after the first day of the January next following the date of entry into force. In New Zealand, the proposed Protocol will have effect with respect to other taxes for taxable periods beginning on or after the first day of April next following the date of entry into force.

Treaty Program Priorities

A key continuing priority for the Treasury Department is updating the few remaining U.S. tax treaties that provide for significant withholding tax reductions but do not include the limitation on benefits provisions needed to protect against the possibility of treaty shopping. I am pleased to report that in this regard we have made significant progress. Most notably, in June 2009 we announced the conclusion of the negotiation of a new tax treaty with Hungary. The new Hungary treaty, which we hope to sign, soon will contain a comprehensive limitation on benefits provision that will ensure that only residents of the United State and Hungary will enjoy the benefits of the treaty. In addition, we recently concluded our second round of negotiations with Poland and plan to hold additional negotiations early next year.

Concluding agreements that provide for the full exchange of information, including information held by banks and other financial institutions, is another key priority of the Treasury Department. 2009 has been a year of fundamental change in transparency, as many secrecy jurisdictions announced their intentions to comply with the international standard of full information exchange. In this changing environment, the Treasury has made many key achievements, including the conclusion of protocols of amendment to the U.S. tax treaties with Switzerland and Luxembourg that provide for full exchange of information, including bank account information. The Administration hopes to transmit these agreements to the Senate for its consideration as soon as possible. Moreover, in the near future we hope to commence or reinvigorate tax treaty negotiations with a number of our other trading partners with bank secrecy rules once those countries have eliminated all domestic law impediments to full exchange of information.

Beyond the two chief priorities of curbing treaty shopping and expanding exchange of information relationships, the Treasury Department continues to maintain a very active calendar of tax treaty negotiations. We have recently held formal treaty negotiations with Colombia and Korea, and later this month will open formal negotiations with Israel.

Conclusion

Mr. Chairman and Ranking Member Lugar, let me conclude by thanking you for the opportunity to appear before the Committee to discuss the Administration's efforts with respect to the three agreements under consideration. We appreciate the Committee's continuing interest in the tax treaty program, and we thank the Members and staff for devoting time and attention to the review of these new agreements. We are also grateful for the assistance and cooperation of the staff of the Joint Committee on Taxation.

On behalf of the Administration, we urge the Committee to take prompt and favorable action on the agreements before you today. I would be happy to respond to any question you may have.

REPORTS

- Technical Explanation for Protocol with France
- Technical Explanation for Protocol with New Zealand
- Technical Explanation for Protocol with Malta

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