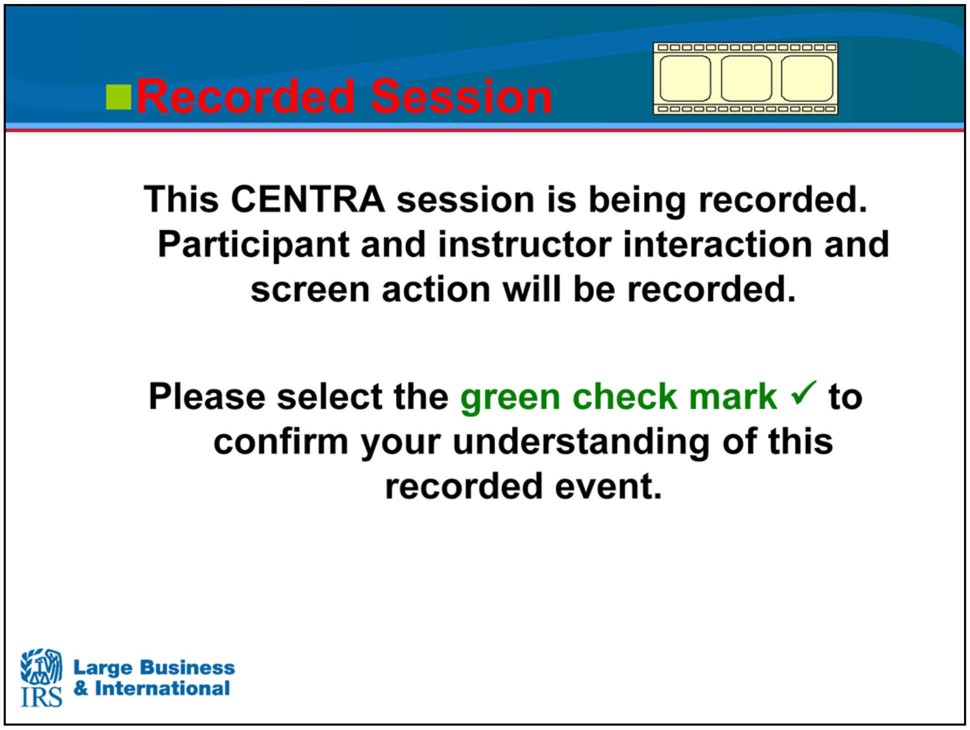


[Speaker]

Before we begin, I would just like to give a reminder that this event is being recorded and will be available for playback.

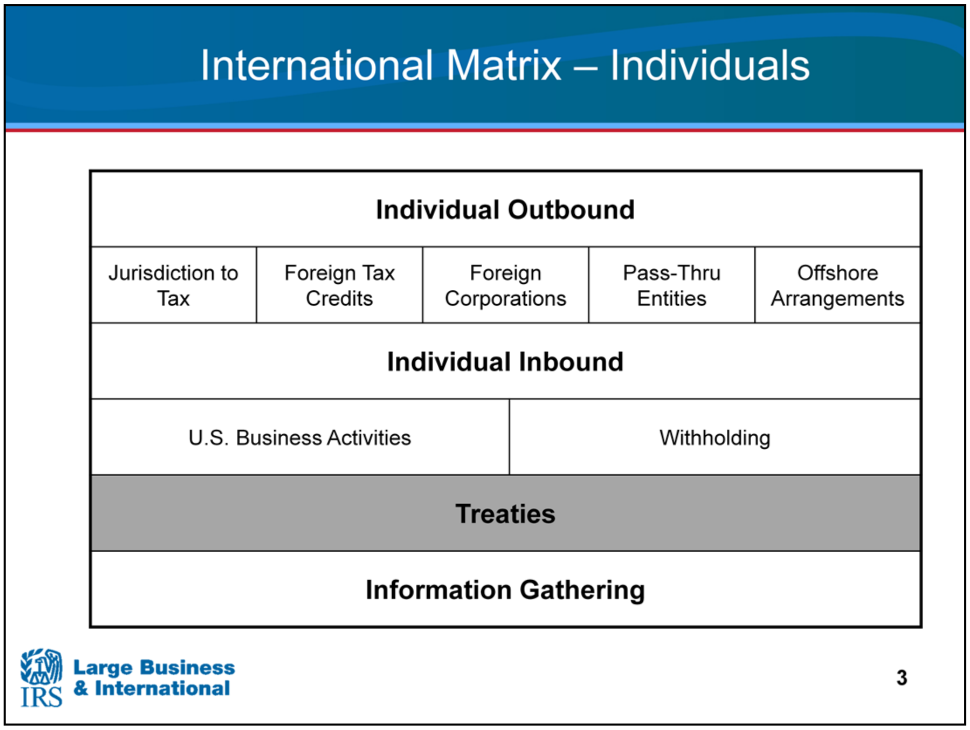
Can you please select the green check mark to confirm you understand that this event is recorded and that, in any event, you should not share any PII during this session?

[Once participants have acknowledged, press the record button]

Hello, I'm Nicole Welch, a tax law specialist in Washington, DC. I am a member of the Treaty Assistance and Interpretation Team within the U.S. Competent Authority. I'm happy to be able to speak with you all today.

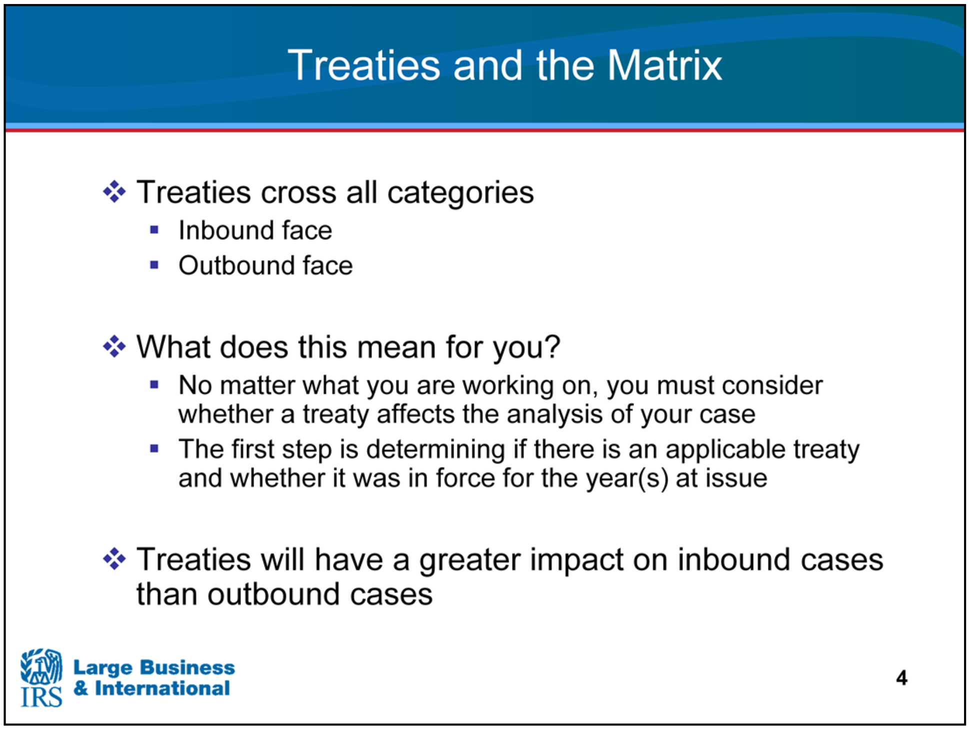
My duties include supporting the Treaties International Practice Network, which often is referred to as the Treaties IPN. The Treaties IPN was created to connect and develop expertise on treaties issues throughout LB&I International.

In my role, I've already had the opportunity to interact with some of you, and I look forward to working with the rest of you.

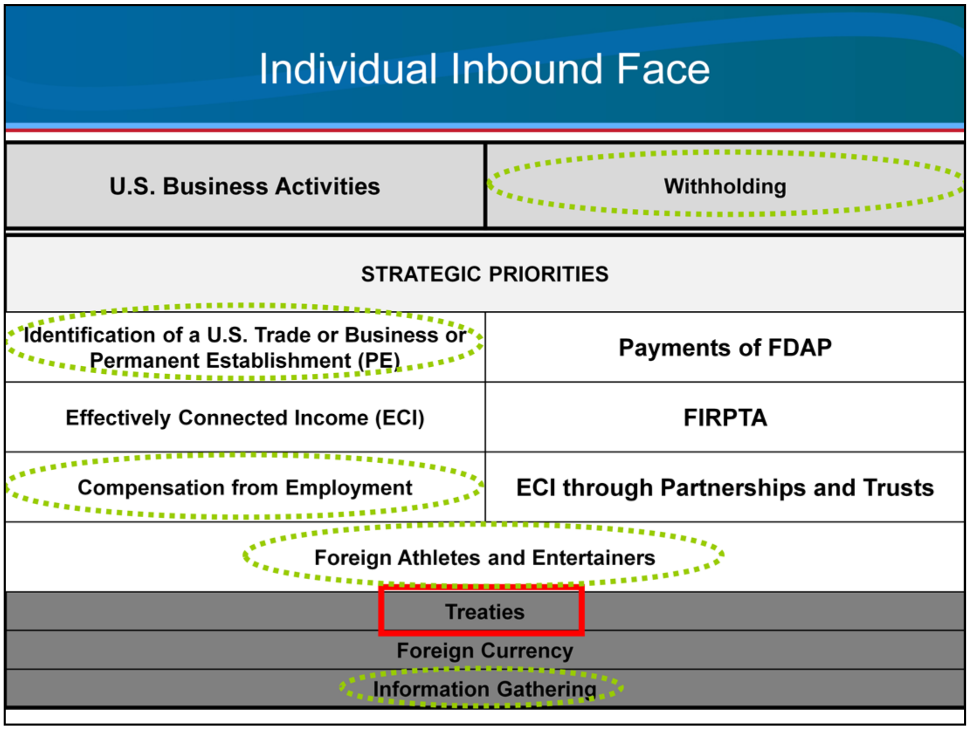


As you've already seen in the course of this training, treaties issues can arise in all of the other areas of international tax. In other words, treaties cut across every area of international taxation.

This is reflected on the Individual Face of the International Matrix. The International Matrix shows how the various pieces of international tax fit together.
The matrix is intended to show that treaties can come into play in each facet of the taxation of individuals.

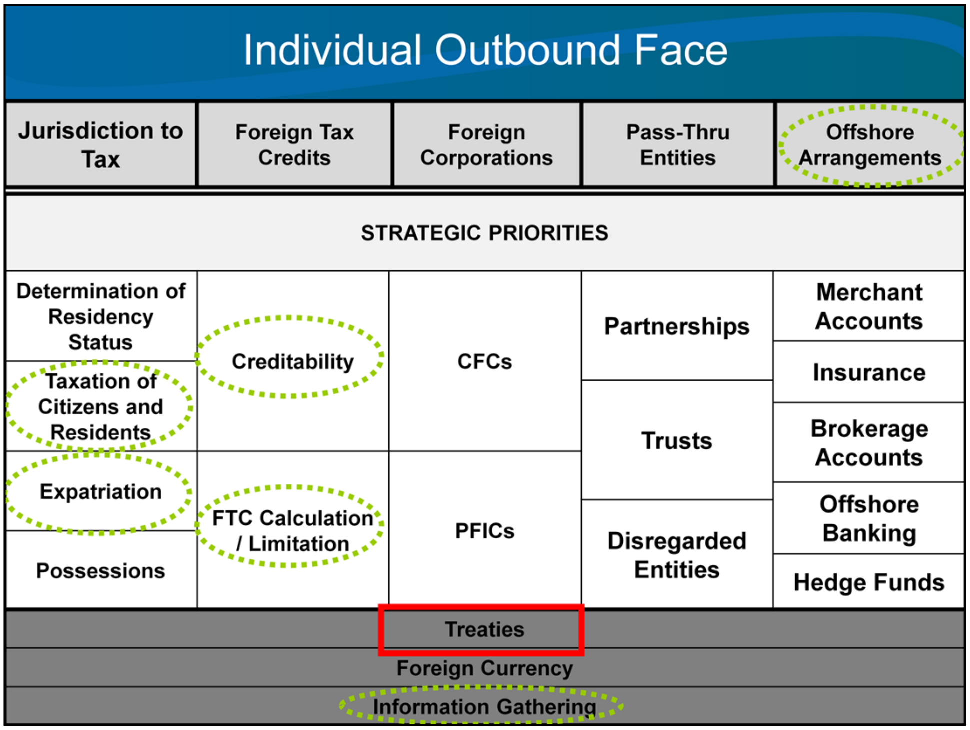


As the previous slide showed, Treaties can arise in both Inbound and Outbound scenarios.

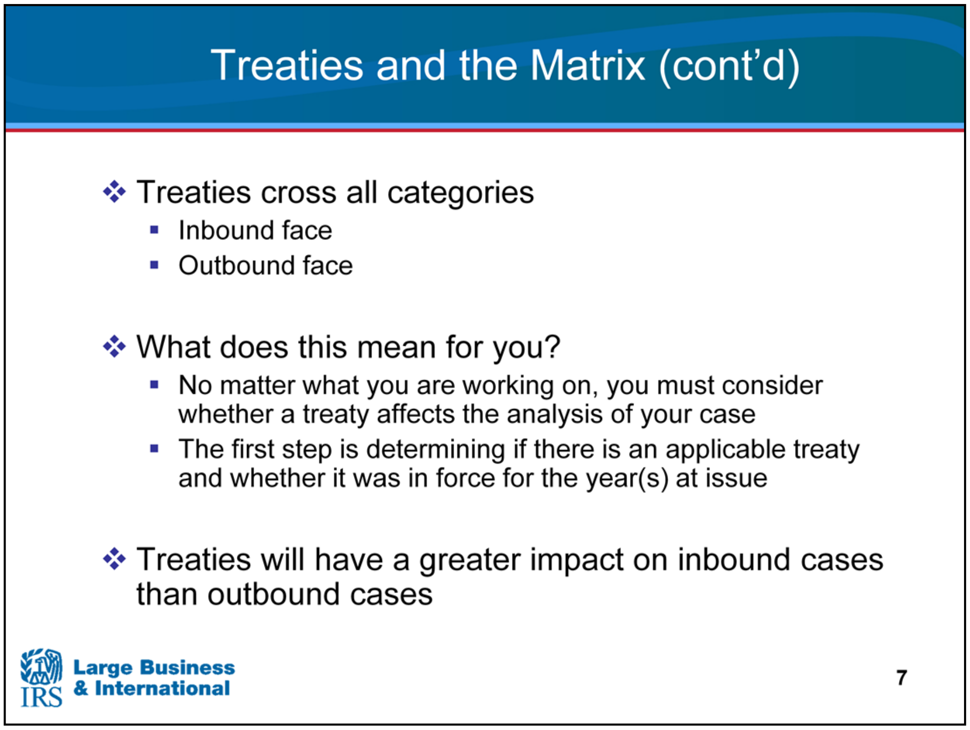


As the previous slide showed, Treaties can arise in both Inbound and Outbound scenarios.

For example, in the Inbound context, a treaty might affect the withholding rate applicable to payments of U.S.-source FDAP income—think interest, dividends, royalties—made to a foreign individual investor. It also might affect whether the United States can tax compensation earned by a nonresident for rendering personal services in the United States.



On the Outbound side, the treaty might limit the amount of taxes a foreign country can impose on a U.S.-resident individual. And, if the individual pays more than the treaty allows, he wouldn’t be able to claim a foreign tax credit in the United States for that portion of his foreign taxes unless he exhausts his avenues for reducing that foreign tax, including by requesting assistance from the U.S. Competent Authority.

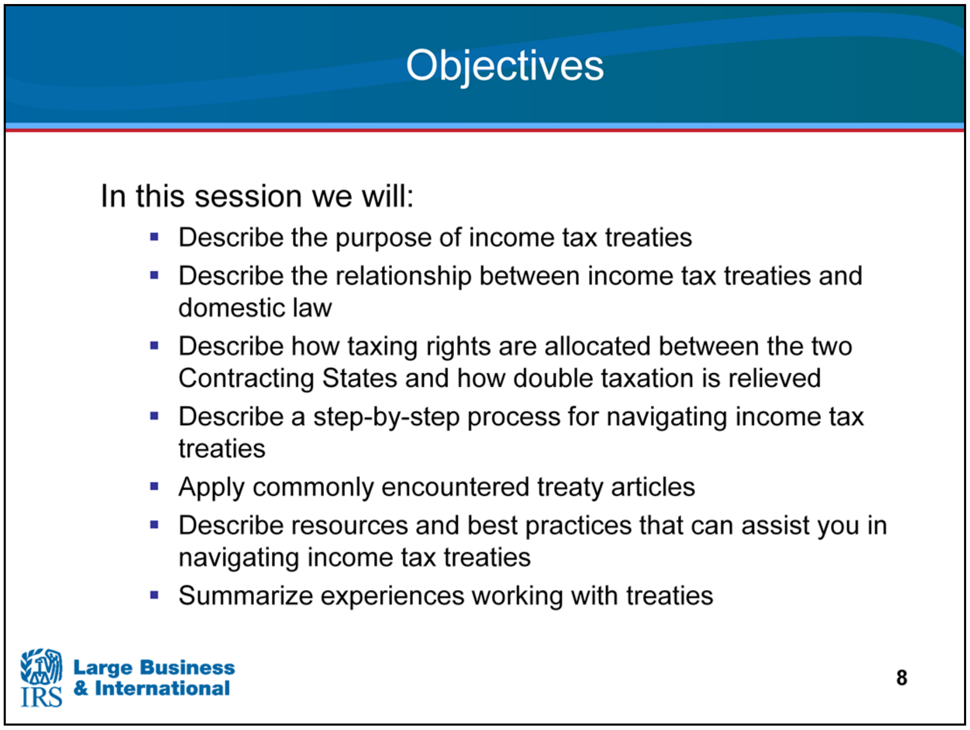


So, what does this mean for you?

It means that no matter what you are working on, you need to consider whether a treaty affects the analysis of your case.

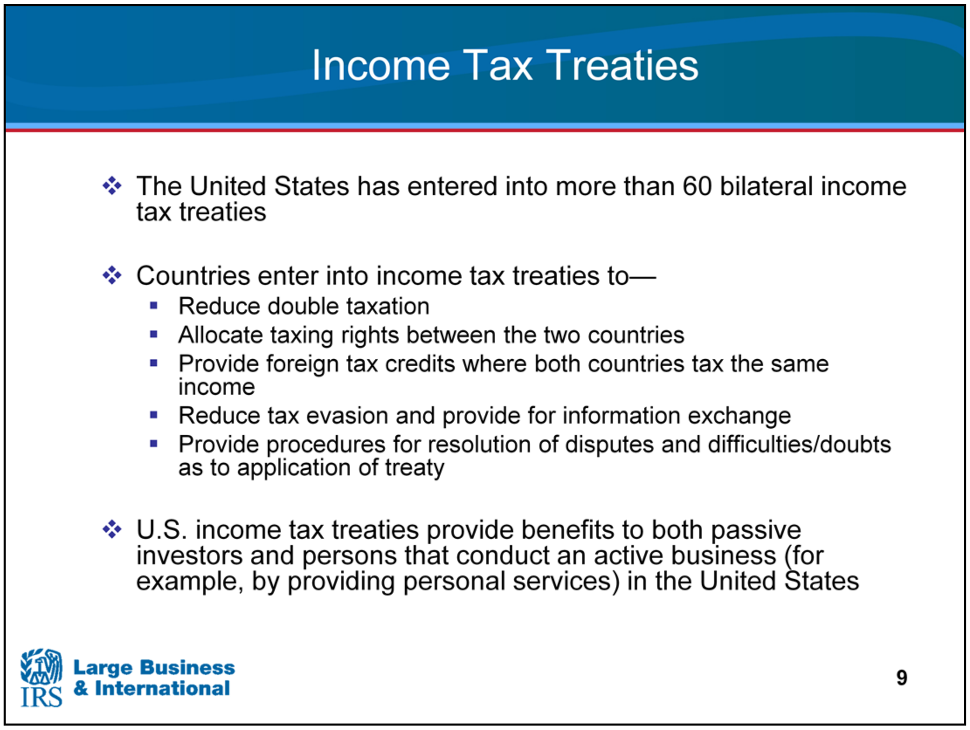
To do this, the first step will be to determine if there is an applicable treaty and whether it, or an amending protocol, was in force for the year(s) at issue. There is a link on the Treaties IPN SharePoint site under "Best Practices" to a document maintained by Branch 7 of the Office of the Associate Chief Counsel (International) that lists all of our treaties, as well as "in force" dates for many. Another good resource is the "Current Status of U.S. Tax Treaties and International Tax Agreements" article that is published monthly by BNA's *Tax Management International Journal* and that we link to under Hot Topics on the Treaties IPN SharePoint page. You also can look to the Entry into Force article of the treaty or amending protocol.

For our purposes, treaties usually will have a greater impact on cases where foreign individuals are investing, working, or doing business in the United States than in cases where U.S. individuals are investing, working, or doing business in a foreign country. However, as we will see later in some of our examples, treaties can impact those outbound cases as well.



To briefly lay out what we will be talking about in this session on treaties, we will:

- Discuss the purpose of income tax treaties
- Discuss the relationship between income tax treaties and domestic law
- Learn how taxing rights are allocated between the two countries that have entered into the particular treaty–also known as the Contracting States—as well as how double taxation is relieved
- Learn a step-by-step process for navigating income tax treaties
- Discuss commonly encountered treaty articles using situations involving different treaties and fact patterns
- Introduce resources and best practices that can assist you in navigating income tax treaties
- And, time permitting, give you an opportunity to share your experiences working with treaties and to ask questions.



So, why has the United States entered into more than 60 bilateral income tax treaties?

Countries enter into income tax treaties for a variety of reasons, including to reduce double taxation. Reducing double taxation means reducing the circumstances in which the same item of income would be taxed by both of the countries that have entered into the treaty. Double taxation generally is relieved by

- Allocating taxing rights on an item of income between the Contracting States, and
- Providing rules for the giving of foreign tax credits when both countries can tax the same item of income.

Countries also enter into income tax treaties to

- Reduce tax evasion and provide for the exchange of information between the two Contracting States and
- Provide procedures for the two countries to resolve disputes about how the treaty applies generally or in a particular taxpayer's situation. These procedures are called "mutual agreement procedures."

[Read main bullet #3.]

This means you might encounter a variety of situations where you will need to apply treaties.

For example, a taxpayer you are examining might claim that a treaty exempts or reduces the amount of tax payable on income otherwise taxable under the Internal Revenue Code.

As another example, in the OVDI context, a taxpayer might argue that a foreign account should not be included in offshore penalty calculations because the taxpayer thinks the treaty says that the United States is not allowed to tax the income generated by the account.

Other Treaties/Agreements

- Estate and/or gift tax treaties
- Tax information exchange agreements (TIEAs)
- FATCA intergovernmental agreements (IGAs)
- Consular agreements
- Status of forces agreements (SOFAs)
- Social security totalization agreements

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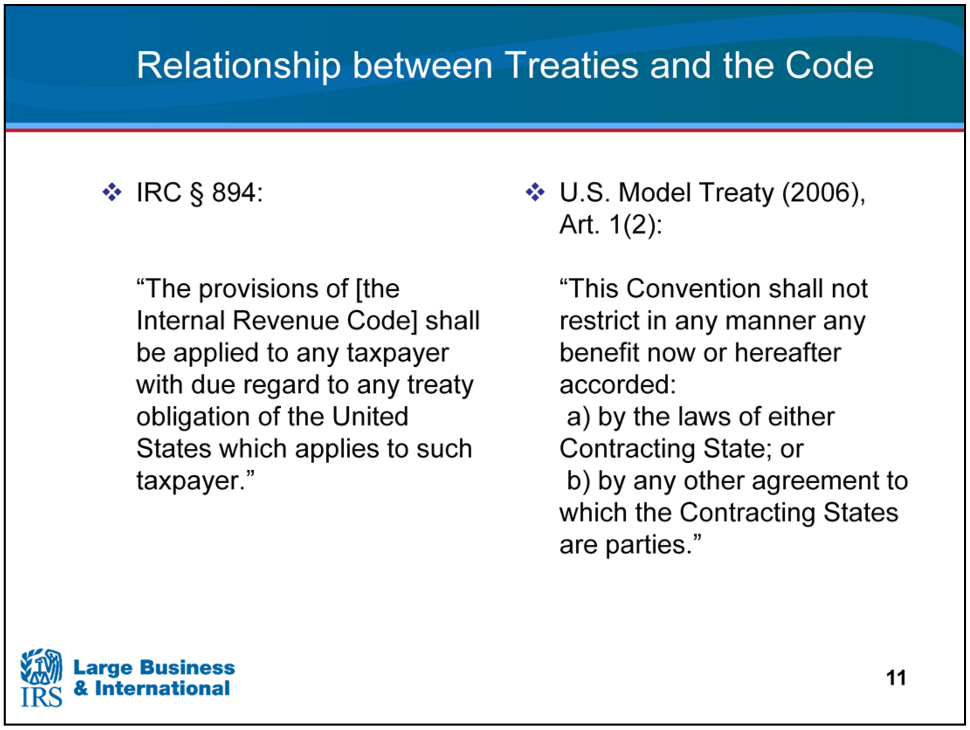
In addition to income tax treaties, the United States enters into other types of bilateral agreements related to tax. We won't be going into detail about these types of agreements, but they include:

- Estate and gift tax treaties, which can affect the application of our estate and gift tax rules;
- Tax information exchange agreements—or TIEAs—which provide for information exchange between the united States and the other country but do not include the provisions for reducing double taxation that are included in our income tax treaties;
- Intergovernmental agreements for the implementation of the Foreign Account Tax Compliance Act, which govern FATCA information reporting by residents of IGA countries and which may or may not piggyback on an existing treaty or TIEA.
- Consular agreements, which provide special rules for how diplomats and consular officers and employees are to be treated in the United States;
- SOFAs, which the United States enters into when U.S. troops are stationed on foreign soil in order to establish the rights and privileges of U.S. personnel present in the host country; and
- Social security totalization agreements, which have the purpose of preventing double taxation of income with respect to social security

taxes. In fact, social security taxes are explicitly excluded from many of our income tax treaties, which means that those treaties do not prevent the United States from imposing social security taxes where otherwise allowed by the Code.



And, now, back to income tax treaties.

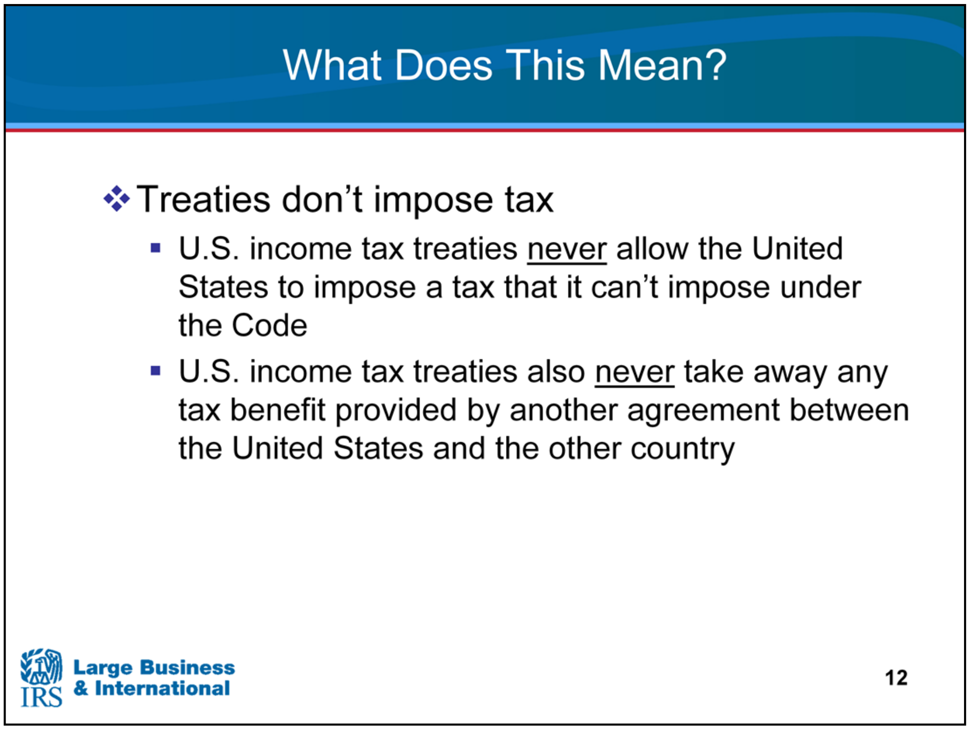
We’ve got the Code, and then we have treaties—how do they relate?

Here’s some technical language from section 894 of the Code and Article 1(2) of the U.S. Model Treaty.

Section 894 says . . . .

Article 1(2), which appears in some form or another in most—if not all—of our treaties, says . . . .

“Convention” is another word for treaty, and as you’ve gathered, the “Contracting States” are the countries that are party to the treaty.



Okay . . . What does this technical language mean?

It boils down to this: Treaties don't impose tax.

And, what do we mean when we say that treaties don't impose tax?

First, [read first bullet]. For example, although the Code says that generally interest paid to a nonresident alien is subject to a 30-percent withholding tax, the Code also says that we generally can't impose that withholding tax on bank deposit interest paid to a nonresident alien. Therefore, even if the treaty says that we can tax U.S.-source interest—including bank deposit interest—paid to a resident of our treaty partner at 10 percent, we have to abide by the Code, which says we can't tax it at all.

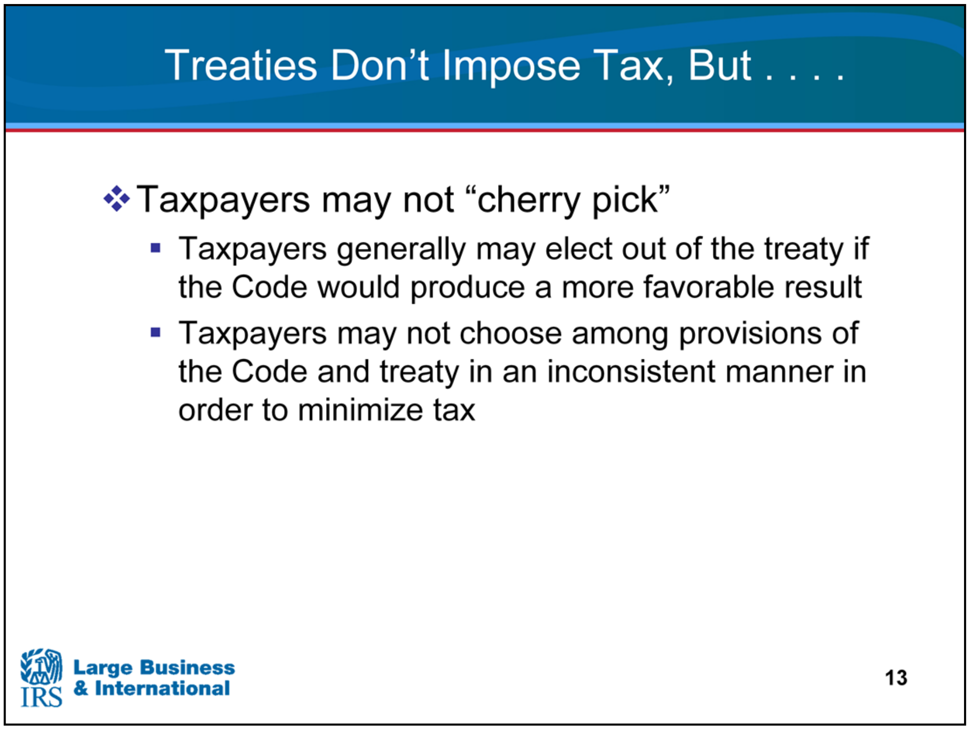
This brings us full circle with the very first session you attended as part of this training. If you recall, that covered the United States' jurisdiction to tax. A treaty does not give us jurisdiction to tax a person; it only can modify an ability to tax that we already have under the Code.

Second, [read second bullet]. For example, assuming the Code allows us to tax an item of income, if the treaty also says we can tax it, but a SOFA says we cannot tax it, then the SOFA trumps.

CPE Question #1:

Treaties are <u>not</u> intended to do which of the following?
A) Provide rules to prevent or alleviate double taxation;
B) Allow for the exchange of information between tax administrations;
C) Give the United States jurisdiction to tax income that it would not otherwise have; or
D) Provide procedures for resolving disputes that arise regarding application of the treaty.

Answer: C



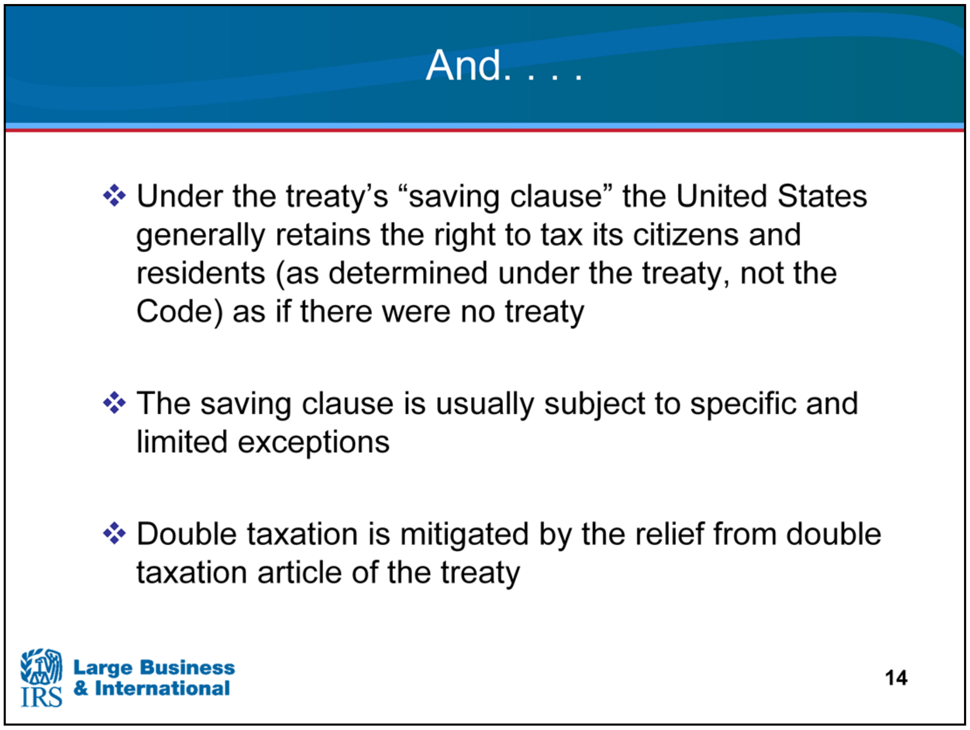
And now we will go over a few more basic treaties principles that can help you identify issues or reach the right conclusion, even when the text of the treaty might be complicated.

First, remember how we said that a treaty cannot make a taxpayer worse off than he would be under the Code? Although this is true, taxpayers may not, quote-unquote, cherry pick between Code and treaty provisions.

Taxpayers may elect out of the treaty if the Code would produce a better result. For example, a dual resident taxpayer might prefer to be taxed on her worldwide income under the Code because she would then be allowed to claim deductions like the standard deduction. A dual resident taxpayer also generally can switch between Code treatment and treaty treatment from one year to the next—assuming that he or she meets all of the substantive requirements for treaty benefits in a year that treaty treatment is elected.

Finally, even though taxpayers who are entitled to claim treaty benefits can decide whether the Code or the treaty will give them the better result and file on that basis, taxpayers may <u>not</u> choose among provisions of the Code and treaty inconsistently in a single taxable year. For example, where a nonresident alien taxpayer who is married to a U.S. citizen or resident alien has elected to be treated as a resident alien under Code section 6013(g) in order to allow the filing of a joint return, the regulations make clear that individual may not claim not to be a U.S. resident under a U.S. tax treaty.

Later on, we'll go over an example where the taxpayer tries to do this in a single taxable year.



Not only are taxpayers not allowed to cherry pick, but [read bullet #1]. In some of our treaties, the saving clause also applies to former U.S. citizens and former long-term resident aliens for 10 years after losing such status. We'll look at the actual text of some saving clauses later on.

As an example of how the saving clause works, many of our treaties say that interest beneficially owned by a resident of the other country can be taxed only by the other country. However, if that person is a U.S. citizen, then the saving clause says that we can tax that person's worldwide interest income anyway—despite the fact that person also is a resident of the other treaty country.

However, [read bullet #2]. If a treaty provision is excepted from the saving clause, that means even a U.S. citizen or treaty resident can claim benefits under that provision from the United States, provided that the specific requirements of the treaty provision are met. These exceptions usually include the relief from double taxation article and the nondiscrimination article. They also include the mutual agreement article.

Sometimes, a treaty might have two different sets of exceptions to the saving clause: one set that applies to everyone who otherwise would be taxable by reason of the saving clause, including U.S. citizens, and another set of exceptions that apply only to U.S. residents who are not U.S. citizens or green card holders.

As I just mentioned, [read bullet #3], which is why this article is excepted from the saving clause and the United States is obligated to provide benefits under this article to U.S. citizens and treaty residents.

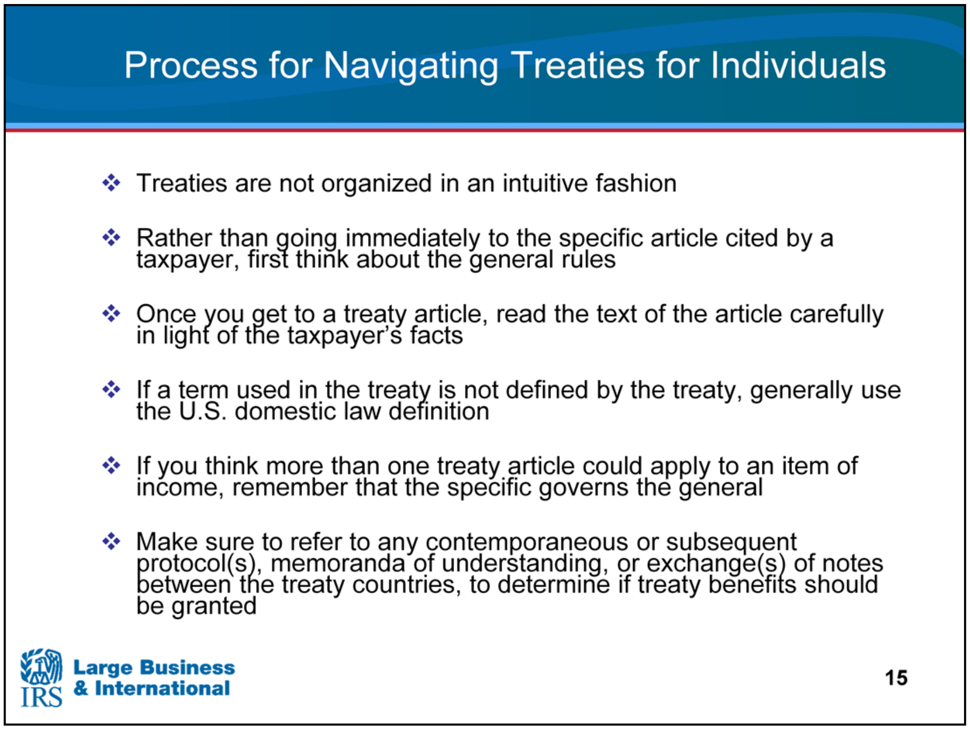
If we go back to the interest example that I just gave, the interest article of the treaty says that the other country can tax the interest, and the saving clause says that we can tax it.

The relief from double taxation article, which applies to U.S. citizens because it is one of the exceptions from the saving clause, provides ordering and other rules for determining which country provides a foreign tax credit or deduction when both countries tax the income.

CPE Question #2

True or False: If a U.S. citizen is a resident of a country with which the United States has entered into an income tax treaty, the treaty prevents the United States from taxing that individual in all cases.

Answer: False. Actually, the saving clause has almost the opposite effect. The saving clause says that the United States can continue to tax a U.S. citizen in almost all instances. The only restrictions that the treaty imposes on the United States' ability to tax that person will be specifically listed as exceptions to the saving clause.



Now that we've gone over some general principles, here are the things I try to keep in mind when I'm applying treaties.

First, [Read bullet #1] This makes reading a treaty from front to back without a more targeted game plan a time-consuming, likely inefficient endeavor. Not only are treaties not organized intuitively, not all treaties are organized the same way!

So when starting to apply a treaty in a particular case, I don't start reading at Article 1, paragraph 1. Also, rather than going immediately to the specific article cited by a taxpayer, I first think about the general rules and principles underlying income tax treaties. For example, I ask, "Is this individual a U.S. citizen? And if so, what does that usually mean from a treaties perspective?" Doing this this might lead you to determine that more than one article might be in play—say . . . the pension article, the saving clause, and the relief from double taxation article.

Then, once I get to a treaty article, I read the text of the article carefully in light of the taxpayer's facts. No matter how many times you've looked at the saving clause in the U.S.-France treaty or how confident you are that the dividends article in the U.S.-Ireland treaty says what you think it says, go and re-read the text carefully and with your taxpayer's particular situation in mind. This will help you figure out if you might have an issue and, if so, what questions you will need to ask the taxpayer.

Next, the treaty might define a term either in the particular article that applies to the income in question or in the general definitions article of the treaty. For example, the royalties article often has a specific definition of what are considered "royalties" for purposes of the treaty, and the general definitions article often defines terms that might be used in multiple treaty articles, like "person," "company," and "national of a Contracting State."

However, [read bullet #4], as set forth in relevant or analogous Code sections, case law, regulations, or rulings—unless the context otherwise requires. The context would require using a different definition if using the U.S. domestic law definition leads to a result that is different from the result intended by the treaty partners.

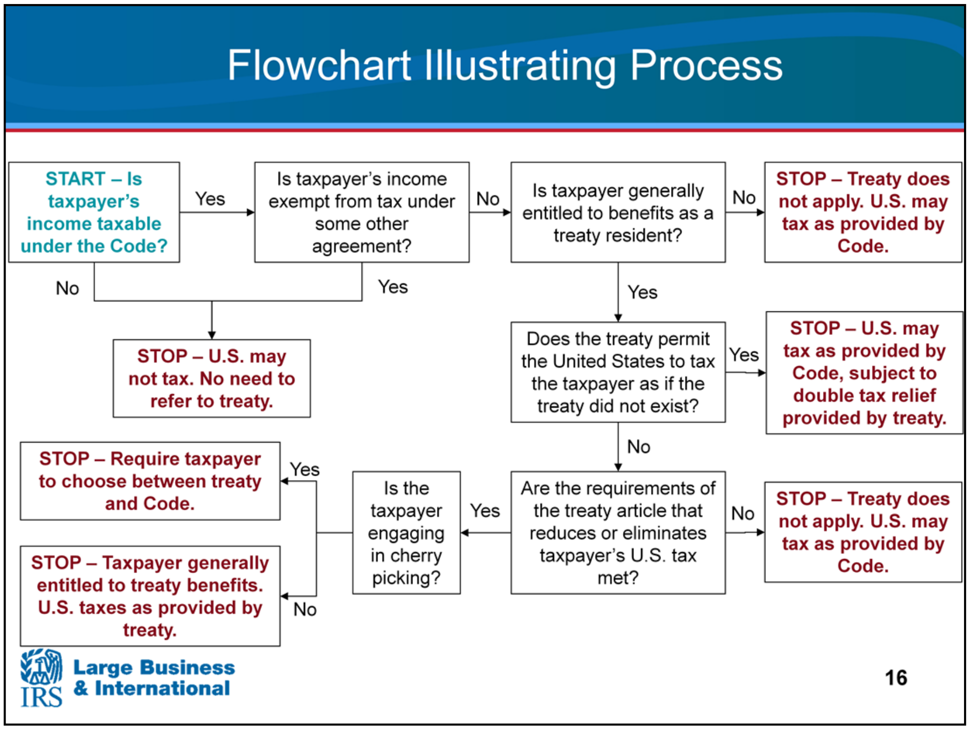
Next, [read bullet #5] What do I mean when I say this?

Well, here is an example from the inbound perspective. Think about a foreign individual who teaches in the United States as an employee of a university. If the treaty has both an Income from Employment article and a Teachers article, then look to the Teachers article first.

Note, however, particularly in the context of teachers and researchers, that the titles of the articles can be misleading. For example, teachers might fall under the article called "Researchers" in some treaties, and some treaties use the title "Scholars."

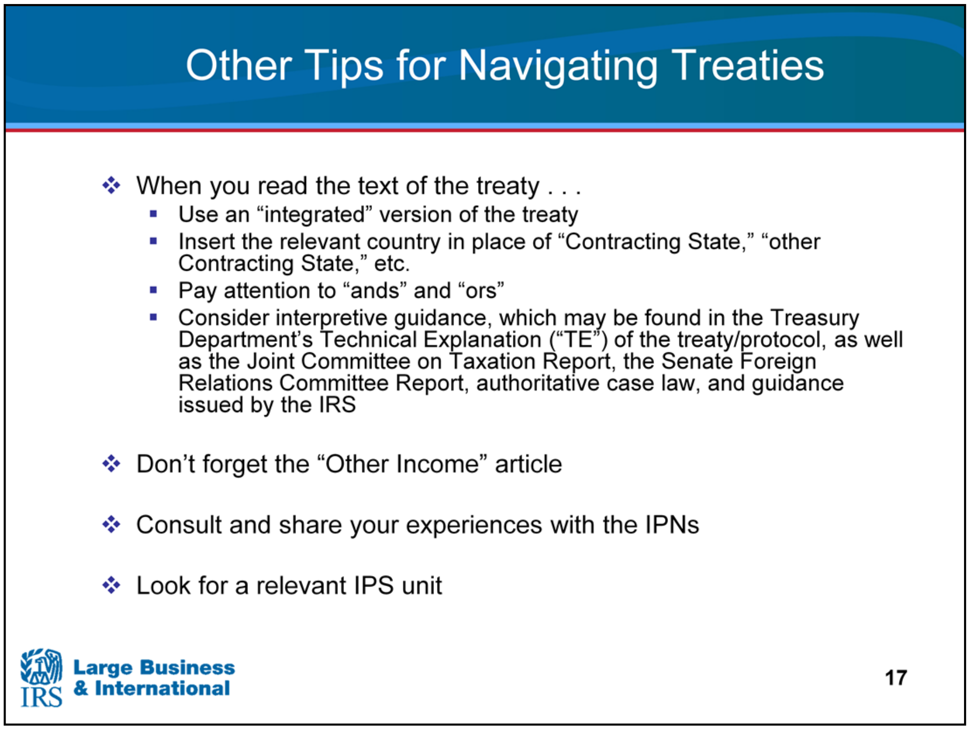
Finally, [read bullet #6]

These agreements might have modified or provided clarification of the original text of the treaty.



I'm a flowchart person, so I hope this might be a useful framework for you all too. This is the high-level thought process that I go through when I get questions about whether and how a treaty applies in a given case.

[Walk through flowchart, emphasizing at end that entitlement to treaty benefits requires eligibility for benefits and meeting all applicable treaty and domestic law rules (e.g., beneficial ownership; form over substance; etc.)]



Here are some other tips for navigating treaties.

When you read the text of the treaty, use an "integrated" version of the treaty. An integrated version is a copy of the treaty whose text reflects amendments made by protocol. Using an integrated treaty—provided the protocol integrated into the text was in force in the year at issue—saves you the time of flipping back and forth between two or more documents to determine what rules apply. You can find integrated versions of many treaties on Lexis and Westlaw. Note, however, that some protocols have standalone provisions are not easily integrated into the texts of the treaties, so you might need to look at those protocol documents separately. One example is Mexico.

Also, when you read the text of the treaty, insert the relevant country in place of "Contracting State," etc. I'm old fashioned—at least in this respect!—so I print out the text and use a pen to do my cross outs, but you can also do this by cutting and pasting into Word. Doing this helps me from getting which country can (or has to) do what mixed up.

It also is important to pay close attention to "ands" and "ors." Just as with interpreting the Code or regulations, they obviously can make a big difference! Sometimes, I circle them to highlight them for myself.

Another tip is to look at interpretive guidance, like the Treasury Department's Technical Explanation, which might use plainer language and concrete examples to describe the relevant rules

Next, don't forget the Other Income article. The other income article applies when the taxpayer derives an item of income that is not covered by any other article of the treaty. Examples might be income sourced in a third country or gambling income. Our treaties' Other Income articles vary as to which country is allowed to tax other income.

Finally, [read bullet #4 and bullet #5] [Elaborate]

CPE Question #3

A resident of Hong Kong claims that the U.S.-China income tax treaty reduces the rate of withholding tax payable on dividends he received from a U.S. corporation. Article 3 of the treaty defines "China" as "all the territory of the People's Republic of China, including its territorial sea, in which the laws relating to Chinese tax are in force, and all the area beyond its territorial sea, including the sea-bed and subsoil thereof, over which the People's Republic of China has jurisdiction in accordance with international law and in which the laws relating to Chinese tax are in force." Your research indicates that the laws relating to Chinese tax are not in force in Hong Kong. However, the State Department webpage you read says that China has had sovereignty over Hong Kong since 1997.

Which definition of "China" should you use to determine if the taxpayer is a resident of "China" under the treaty?
A.The definition in Article 3
B.The State Department information

Answer: A, you use the treaty definition when the treaty has one. Here, you also would have been helped to the right answer if you followed one of the other tips: Looking at the Technical Explanation to Article 3, which says, “The ‘People's Republic of China’ does not include Hong Kong, as Chinese tax laws are not in effect there. Moreover, in accordance with the Agreement between the United Kingdom and China on the future of Hong Kong, the taxes imposed by the Hong Kong Special Administrative Region will continue to be independent of the tax laws of the Central People's Government, and therefore the Agreement will not apply to Hong Kong even after 1997.”

5 Minute Stretch Break

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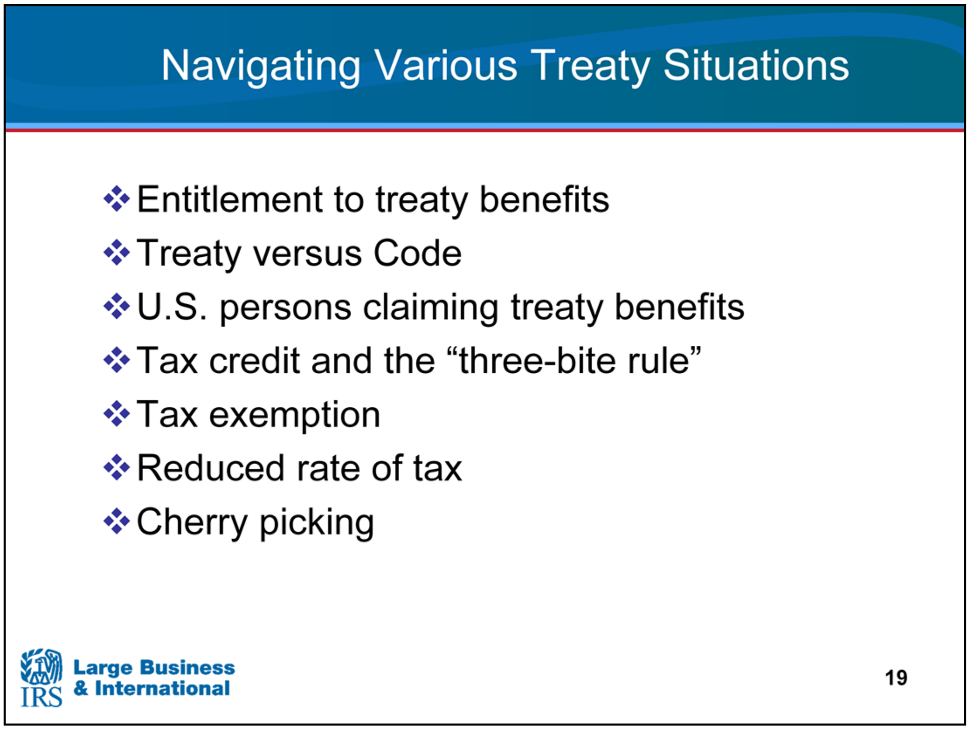
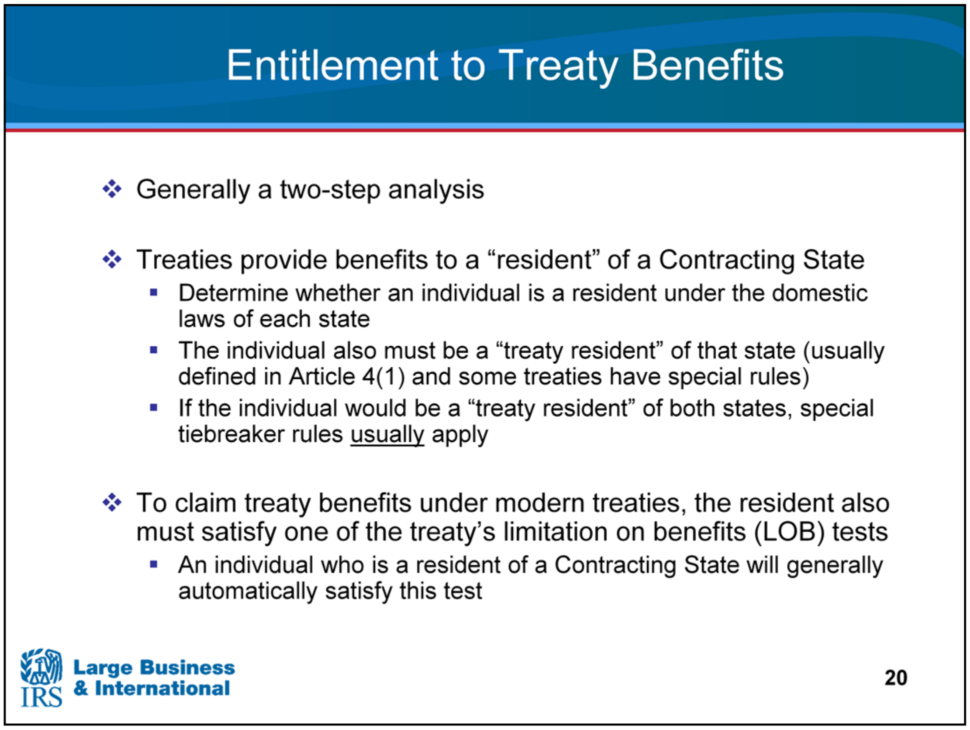
Now we'll take a 5 minute stretch break before we start applying these general principles to some examples. We'll resume again at [TIME].



Welcome back everyone! Let's put the general principles to the test and navigate through some particular situations involving treaties. Let's start with the question of whether an individual is entitled to treaty benefits in the first place.



Whether a person is entitled to treaty benefits generally is a two-step analysis.

First, a person has to be a resident of a Contracting State to be entitled to treaty benefits. [Explain sub-bullets #1-3]

Second, in addition to being a resident of a Contracting State, the person must satisfy one of the treaty's limitation on benefits—or LOB—tests if the treaty has an LOB article. The United States includes these tests in its modern treaties to help ensure that persons that do not have a strong connection to one of the treaty countries do not inappropriately claim treaty benefits. Older treaties might not have an LOB article.

That being said, an individual who is a resident of a Contracting State will generally satisfy the LOB requirement.

Let's look at Article 4 of the U.S.-France income tax treaty.

U.S.-France Tax Treaty, Art. 4

1. For the purposes of this Convention, the term 'resident of a Contracting State' means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management, place of incorporation, or any other criterion of a similar nature. But this term does not include any person who is liable to tax in that State in respect only of income from sources in that State, or of capital situated therein.

2.(a) France shall consider a U.S. citizen or an alien admitted to the United States for permanent residence (a 'green card' holder) to be a resident of the United States for the purposes of paragraph 1 only if such individual has a substantial presence in the United States or would be a resident of the United States and not of a third State under the principles of subparagraphs (a) and (b) of paragraph [4].

4. Where, by reason of the provisions of paragraphs 1 and 2, an individual is a resident of both Contracting States, his status shall be determined as follows:

(a) he shall be deemed to be a resident of the State in which he has a permanent home available to him; if he has a permanent home available to him in both Contracting States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (center of vital interests);

(b) if the State in which he has his center of vital interests cannot be determined, or if he does not have a permanent home available to him in either State, he shall be deemed to be a resident of the State in which he has an habitual abode;

(c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the State of which he is a national;

(d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

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Here, I've included the portions of Article 4 that are relevant to situations where an individual is claiming benefits as a resident of the United States or France under the U.S.-France income tax treaty. You can read through this carefully later on, but for now I'll walk you through the main elements.

Paragraph 1 contains the basic rule we discussed on the last slide. [Walk through paragraph 1]

Paragraph 2(a) contains a special exception to the basic rule. [Explain paragraph 2(a)] Note that this type of exception is specifically bargained for by our treaty partners and is not included in all of our treaties.

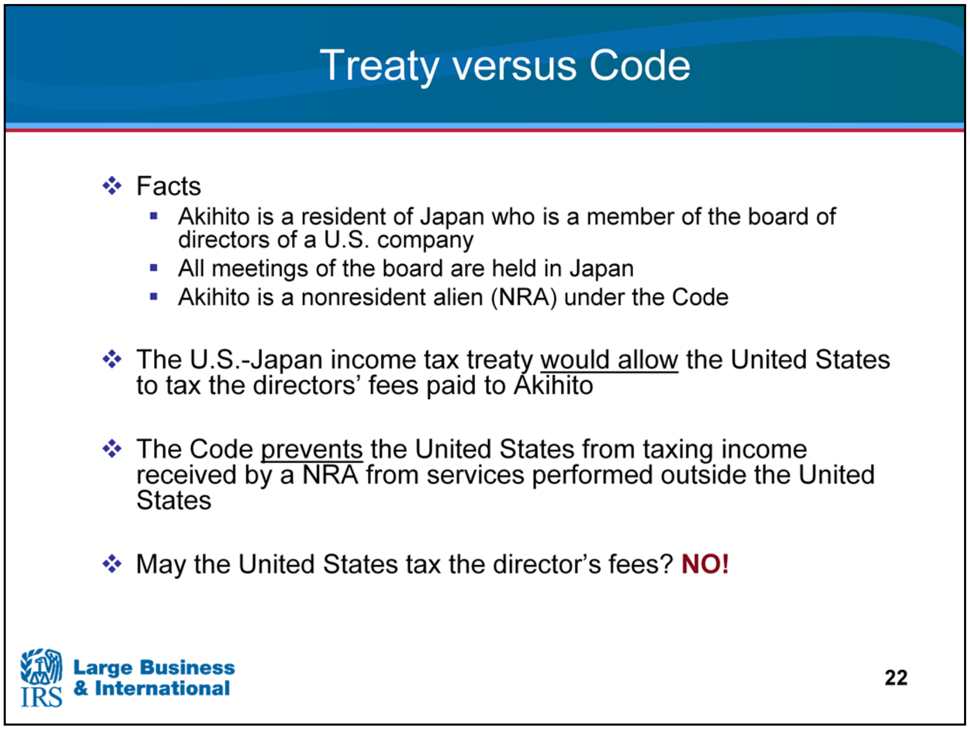
Paragraph 4 has the tiebreaker rules that would apply if the individual claiming treaty benefits would be a resident of <u>both</u> the United States and France under paragraph 1. An example where this could occur is if the taxpayer, let's call her Madeleine, [Walk through paragraph 4]

CPE Question #4

Pierre is a French citizen who received a green card in 2009 while he was living and working in the United States. He left the United States in 2011 and has a returned a few times since while on vacation. For 2012, Pierre filed a Form 1040NR and Form 8833 claiming that he was a resident of France entitled to benefits under the U.S.-France income tax treaty. Which of the following items of information would <u>not</u> be relevant to your determination whether Pierre qualified for treaty benefits?

A) Whether Pierre paid taxes as a resident of France in 2012;
B) Whether Pierre paid taxes as a resident of a third country in 2012;
C) Where Pierre has permanent homes available to him; or
D) None of the above—they are all relevant.

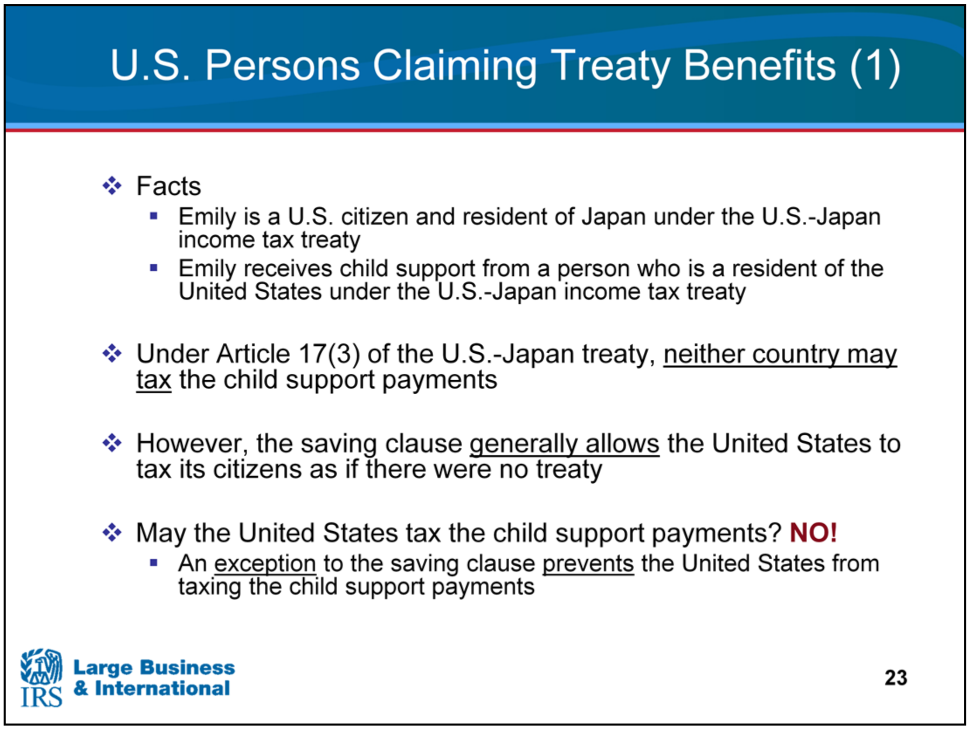
Answer: B, because Pierre is not claiming benefits from France in this scenario.



Now let's talk about an example where the treaty would provide a worse result for the taxpayer than the Code.

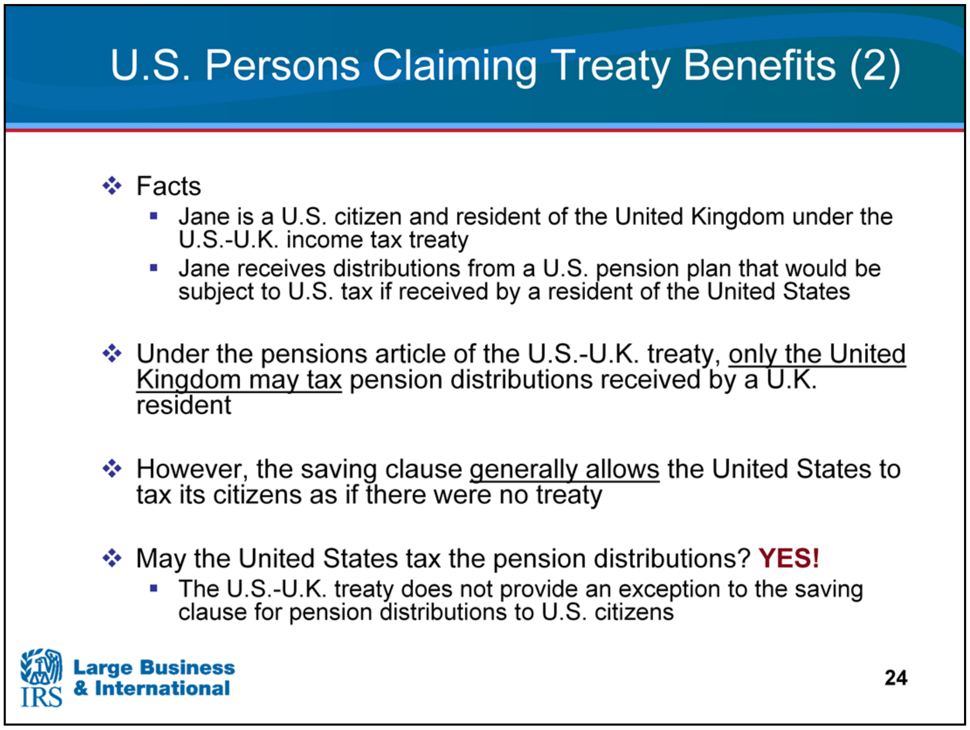
Here, [read through slide]

This is a case where keeping the general rule that "Treaties don't impose tax" can help you reach the correct conclusion.



Now we will discuss two contrasting examples that involve another of the general rules—the saving clause.

In the first example, [read through slide]



In the second example, [read facts]

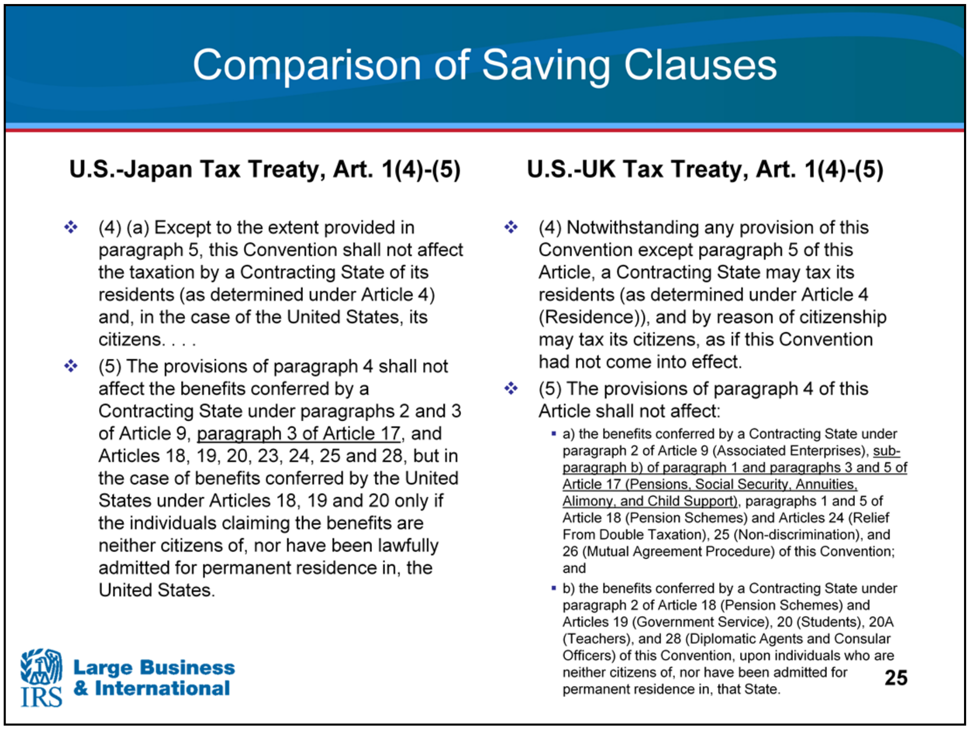
Subparagraph (a) of Article 17(1) of the U.S.-UK treaty says that only the United Kingdom may tax pension distributions received by a UK resident like Jane.

However, this rule is overridden by the saving clause, which in most cases allows the United States to tax Jane, a U.S. citizen, as if the treaty did not exist.

[Read last bullet]

I think of the saving clause as an exception that itself can have exceptions.

Now I will pull up the relevant portions of the text of the saving clauses from both the UK and Japan treaties to show you how this looks in the actual text of the treaties.



As you see, these articles are written in slightly different ways ("Except to the extent provided" versus "Notwithstanding any provision . . . except"), here they have the same basic rule. [Explain]

However, these excerpts also show the importance of carefully reading whatever article you are applying. Look closely at the underlined text in paragraph 5(a) of the UK treaty. It has an exception for subparagraph (b) of paragraph 1 of Article 17 <u>BUT NOT</u> subparagraph (a) of Article 17(1), which is the provision that Jane was trying to rely on in the previous example to exempt her income from U.S. tax. Because subparagraph (a) is not listed as an exception, the saving clause applies to Jane's income.

Before we go to the next CPE question, take a moment to read through the text of the saving clause in the U.S.-Japan treaty. [Pause.] Okay, here is the question.

CPE Question #5

Naoko is a U.S. citizen who lives in Japan. She has attached a Form 8833 to her Form 1040 claiming that capital gains that she recognized from a sale of shares she owned in a U.S. corporation are exempt from U.S. income tax under Article 13 of the treaty. Assuming that Naoko is a resident of Japan under Article 4 of the treaty, do you accept her claim as filed?
Yes, assuming the requirements in Article 13 are met.

No, the saving clause permits the United States to tax the capital gains recognized by Naoko regardless whether the requirements in Article 13 are met.

Answer: No.

Tax Credit

- Without a remedy, in the previous situation Jane might be subject to double tax, which would be contrary to the intent of the U.S.-U.K. income tax treaty
  - The United Kingdom may tax Jane under the pension article of the treaty, and
  - The United States may tax Jane under the saving clause
- Can the treaty reduce this double taxation? **YES!**
  - The double taxation article of the treaty . . .
    - Generally requires one country to allow foreign tax credits (FTCs) for taxes paid to the other country
    - Provides special rules for U.S. citizens who are resident in the United Kingdom (known as the "three-bite rule")

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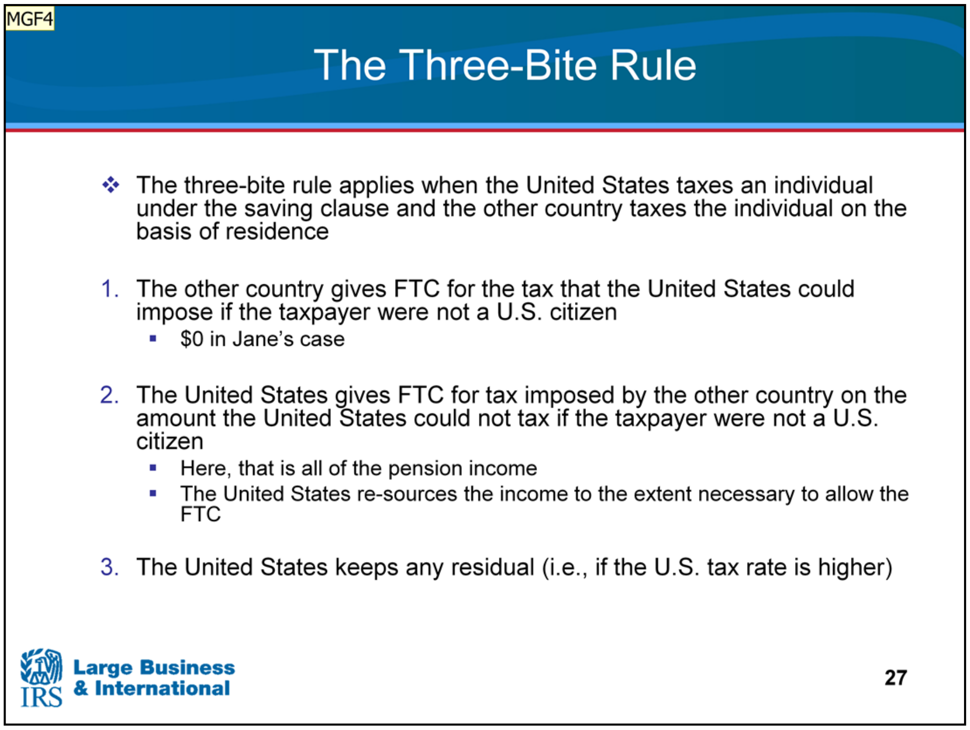
If we think back to our last example, where the United States can tax Jane's pension distributions because of the saving clause, you might be thinking that this result conflicts with another general principle—the principle that income tax treaties are intended to reduce double taxation.

[Read through slide]

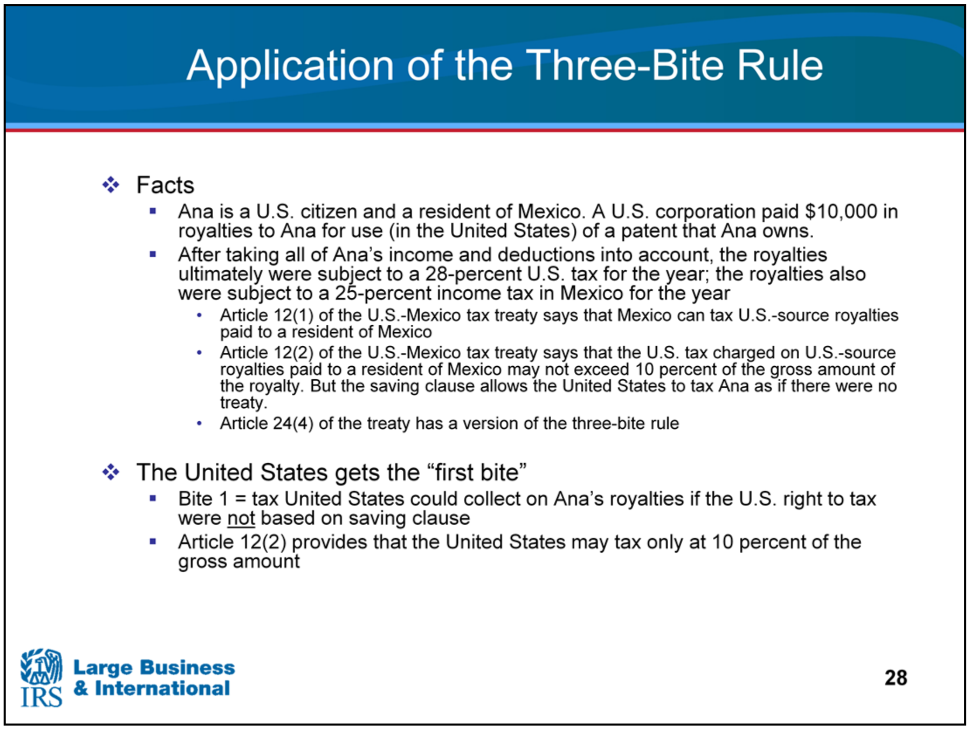


Here is how the so-called three-bite rule works.

[Read through slide]

Slide 27

MGF4 When you talk about the re-sourcing rule in step 2, you may want to mention that if Jane had performed some services outside the US, a portion of each distribution would already be foreign source
Fleeman Grace M, 1/7/2014



Here is a another example. In this example, [read facts]. How would the three-bite rule work in this case?

[Read main bullet 2]. The first bite is [read first sub-bullet]. Determining the first bite requires you to think in hypothetical terms—how much tax would the United States be able to impose on the item of income if Ana were <u>not</u> a U.S. citizen? If, under the hypothetical, the United States would be allowed to impose tax on the royalties, then Mexico must provide a tax credit against its own tax in this amount.

CPE Question #6

What is the amount of the tax credit that Mexico must provide under the first bite?

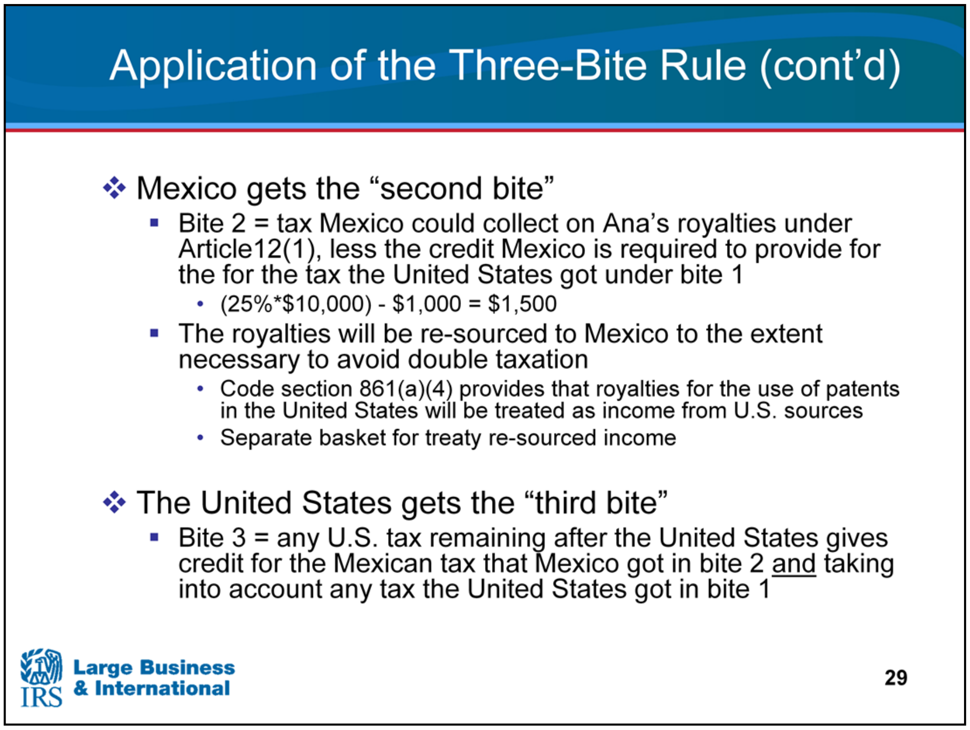
A) $2,800

B) $2,500

C) $1,000

D) $0

Answer: C. The answer is $1,000, which is $10,000 times the 10 percent that the United States is allowed to tax under Article 12(2).



Under the second bite, Mexico gets its share of the tax. Mexico is entitled to [read first sub-bullet]. Here, that is [read second sub-bullet]. Because Mexico is entitled to $1,500 of tax in this case, the United States would provide a foreign tax credit for the $1,500.

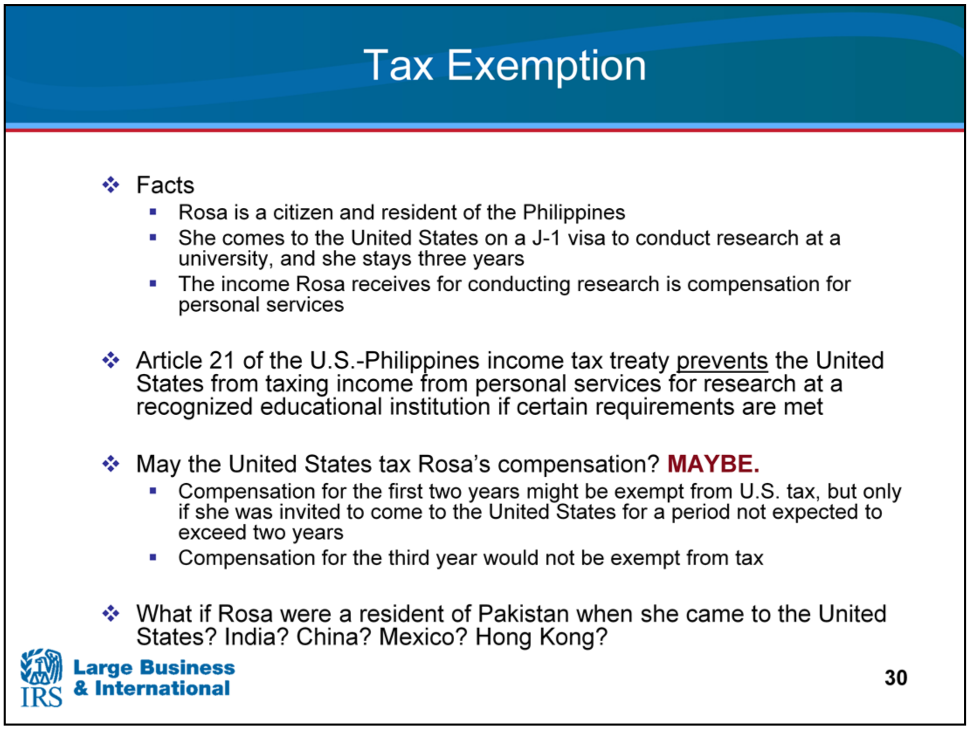
In addition, the treaty re-sources the royalties to Mexico to the extent necessary to avoid double tax. Ordinarily, the royalties would be sourced to the United States under the Code. However, to prevent the foreign tax credit limitation provisions of Code section 904 from unduly limited Ana's ability to credit the Mexican taxes, the treaty provides this re-sourcing provision. Note that the re-sourced income would be put in a special per-country treaty limitation basket.

Finally, [read second main bullet and accompanying sub-bullet].

CPE Question #7

How much tax is the United States entitled to collect under the third bite?
A) $300
B) $1,000
C) $1,300
D) $1,800

Answer: A. The answer is $300, which is the 28 percent U.S. tax allowed by the saving clause minus the $1,500 of tax Mexico was allowed to impose under bite 2 minus the $1,000 tax the United States already got in bite 1. The total U.S. tax (bite 1 plus bite 3) is $1,300.



And now, here is an example where an individual working in the United States seeks to exempt income from U.S. tax by virtue of the treaty.

I know that some of you may be very familiar with this type of fact pattern, but I think it helps illustrates how important it is to carefully read whatever treaty you are applying and also to remember also to evaluate your fact pattern from the perspective of the Code.

Here are the basic facts. [Recite facts]

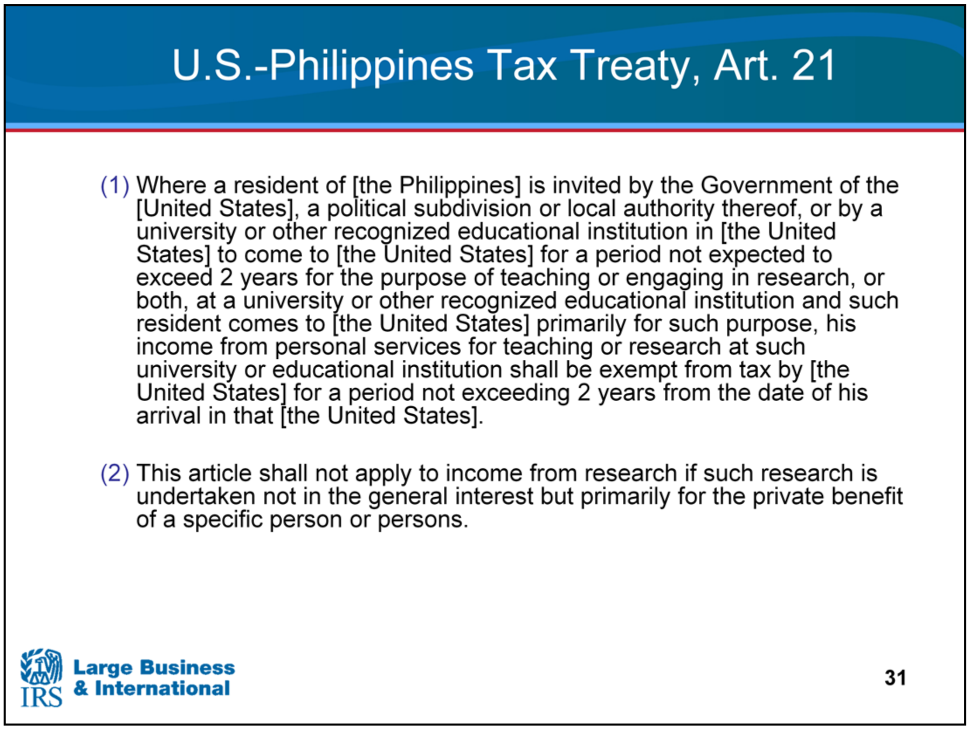
[Read bullet #2] Let’s take a look at Article 21. [Go to next slide]

******

[After coming back to this slide]: Based on these requirements, [read bullet #3]

What if Rosa were a resident of some other country before coming to the

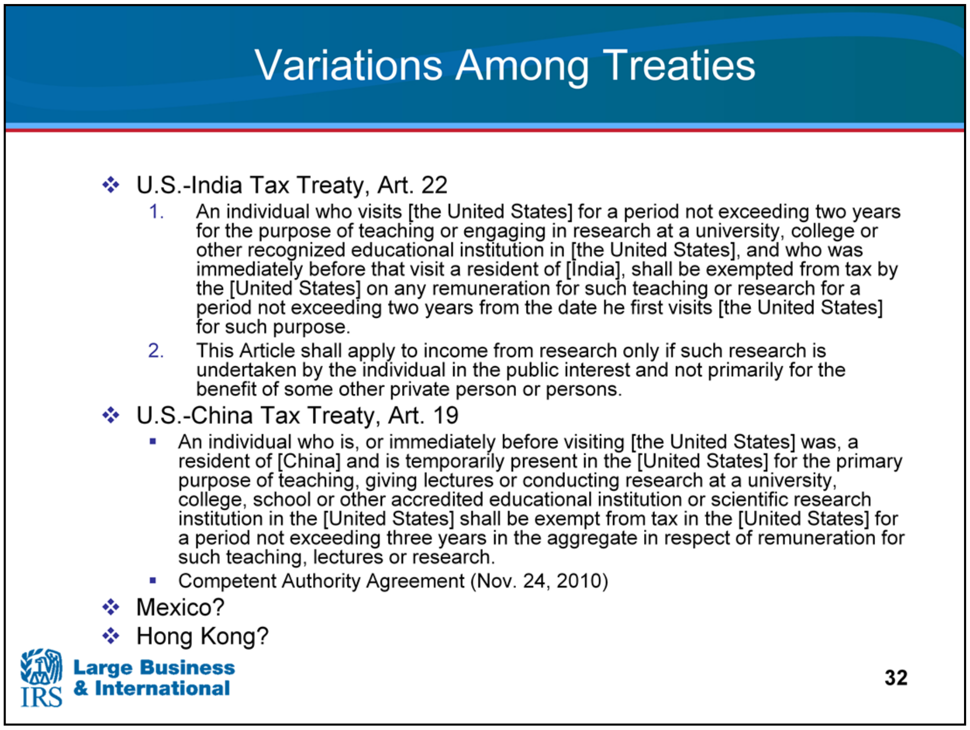
United States? Let's compare some treaties. [Go forward two slides.]



Article 21 says that these requirements are that

- (1) She was a resident of the Philippines before coming to the United States;
- (2) she was invited by the Government or a recognized educational institution within the United States;
- (3) she was invited for a period not expected to exceed 2 years;
- (4) she was invited for the purpose of teaching or engaging in research at the recognized educational institution;
- (5) she did in fact come to the United States primarily to carry out the purpose of the invitation; and
- (6) her research was not undertaken primarily for the private benefit of a specific person or persons.

[Go back to previous slide.]



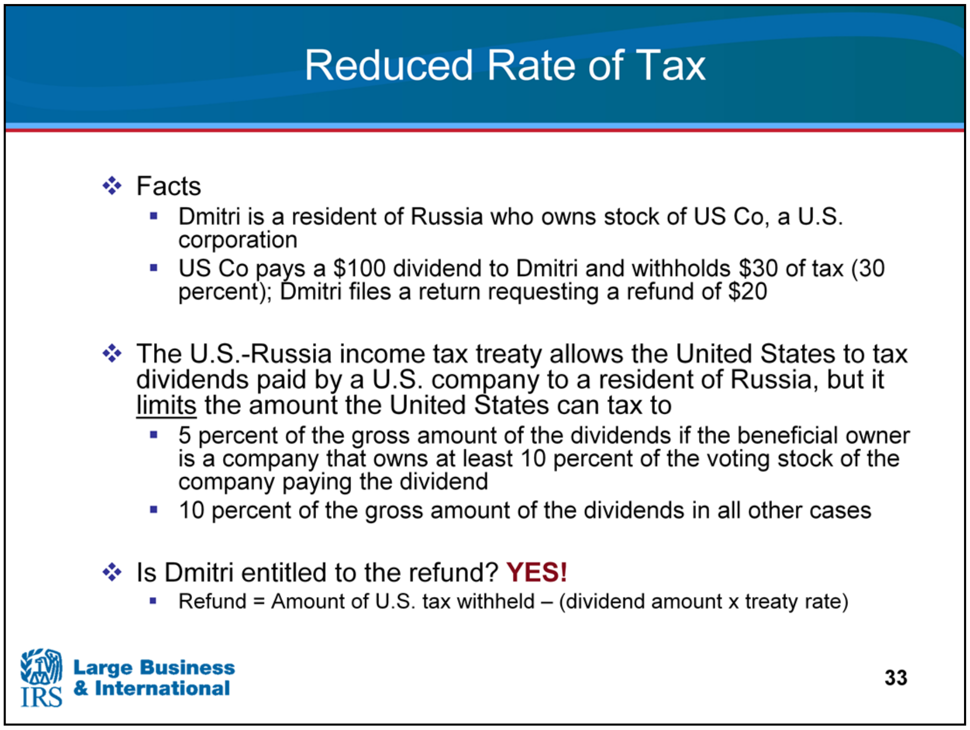
What if Rosa were a resident of India before coming to the United States? The text of that treaty says . . . . [for a period not exceeding two years]
China – three years in aggregate
Mexico – need to go to dependent services article because no specific article for researchers
HK – no treaty

These examples show how there can be great variations in the requirements and benefits depending on which treaty applies, and underscores why it is important to always carefully read the text of the treaty you are applying. Also, in the case of teachers, we [will] have an IPS unit available that gives pointers on how to walk through a teachers' article (or its equivalent) and what questions to ask to get the facts you need to make a determination.

CPE Question #8
Assume Rosa was a resident of China before coming to the United States and claimed an exemption from U.S. tax for the wages she earned as a

researcher during the three years she was in the United States. After those three years, she returned to China for two years. She then returned to the United States a second time to conduct research at a different U.S. university. Is Rosa entitled to exempt her wages from this research from U.S. tax under Article 19 of the U.S.-China income tax treaty?
Yes
No

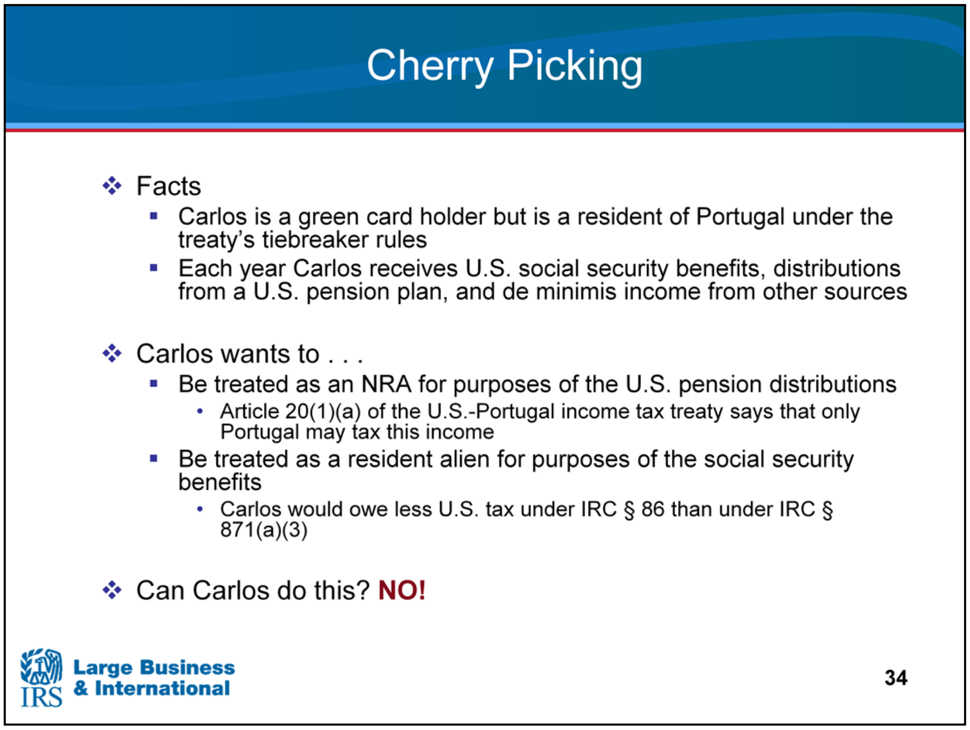
Answer: No. The key language from the treaty is "three years in the aggregate." In fact, the United States and China have entered into a competent authority agreement regarding the interpretation of Article 19, which explains this further. The texts of a number of competent authority agreements are available on irs.gov, organized by country, and you should look at the webpage whenever you have a treaty question to see if there is one on point. The URL to the page is listed at the end of the slides.



Next is an example where a nonresident alien claims a reduced rate of withholding tax under the treaty.

[Read slide]

Note that in the future, Dmitri could avoid having the full 30 percent tax withheld at source (and having to request a refund for the tax that exceeded the treaty rate) if he provides a Form W-8BEN to the withholding agent certifying that Dmitri is the beneficial owner of the shares in US Co and is entitled to a reduced rate of withholding under the U.S.-Russia income tax treaty.



Finally, here is an example where the taxpayer tries to seek inconsistent treatment under the Code and the applicable income tax treaty.

[Read through slide]

Carlos Must Choose

- Carlos must choose between the treaty and the Code
  - Technical Explanation to Article 1(1) of the U.S.-Portugal Tax Treaty
- If he chooses to be treated as an NRA under the tiebreaker,
  - His pension benefits will be exempt from U.S. tax under Article 20 of the treaty, but
  - His social security benefits will be subject to the higher tax provided by IRC § 871(a)(3)
- If he chooses to be a treated as a resident under the Code,
  - His social security benefits will be subject to the lower tax provided by IRC § 86, but
  - His pension benefits will be subject to U.S. tax in accordance with the Code

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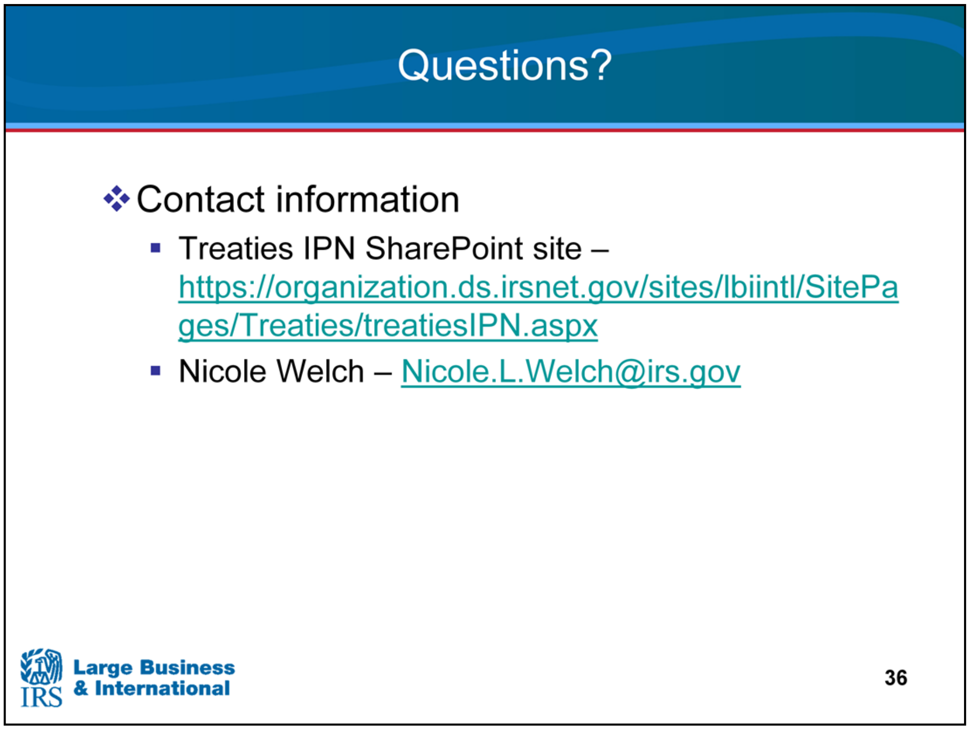
No, Carlos must choose to be taxed under the Code or under the treaty. This general principle is explained in the Technical Explanation to Article 1, paragraph 1 of the U.S.-Portugal income tax treaty. The TE states: "a taxpayer's U.S. tax liability need not be determined under the Convention if the Internal Revenue Code would produce a more favorable result. This does not mean, however, that a taxpayer may pick and choose among Code and Convention provisions in an inconsistent manner in order to minimize tax."

This rule is based on Revenue Ruling 84-17, in which a foreign resident with different trades or businesses in the United States tried to have a loss-making business taxed under the Code and a profit-making business excluded from tax under the treaty due to the absence of a permanent establishment. The ruling concluded that the taxpayer may not use the treaty to exclude the profits of the profitable trade or business and use Code rules to claim the loss of the loss trade or business against the profit of the permanent establishment. However, if the taxpayer invokes the Code for the taxation of all three ventures, however, he would not be precluded from invoking the treaty with respect, for example, to any dividend income he may receive from the United States that is <u>not</u> effectively connected with any of his business activities in the United States.

Given that Carlos must choose between the treaty and the Code, [read bullets 2-end]

It is Carlos's choice. He can pick whichever he thinks makes him better off.



And that concludes the session! Here is my contact information, as well as the location of the Treaties IPN SharePoint site.

It has a lot of useful information, including the treaties list.

Also, until the official IPS library is up and running, we will be putting our units on this page as Hot Topics. [We hope to post units on residency tie-breakers, the saving clause, and teachers soon.]

[And, now, since we have some time, do any of you have questions or experiences you would like to share?]

Finding Treaties

- On IRS.gov – http://www.irs.gov/Businesses/International-Businesses/United-States-Income-Tax-Treaties---A-to-Z
- On Treasury.gov – http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/treaties.aspx
- On Westlaw – RIA-TAXT, RIA-TREATIES, and FTX-TREATIES databases
- On Lexis – CCH Tax Treaties Reporter and Tax Analysts Worldwide Tax Treaties files
- Competent Authority Agreements – http://www.irs.gov/Individuals/International-Taxpayers/Competent-Authority-Agreements

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List of Handouts

- Treas. Reg. § 1.6013-6(a)(2)(v) and Example
- Treaty navigation flowchart
- Treaty excerpts
  - U.S.-France Tax Treaty, Art. 4(1), (2)(a), and (4)
  - U.S.-Japan Tax Treaty, Art. 1(4)-(5)
  - U.S.-UK Tax Treaty, Art. 1(4)-(5)
  - U.S.-Philippines Tax Treaty, Art. 21
  - U.S.-India Tax Treaty, Art. 22
  - U.S.-China Tax Treaty, Art. 19
- Rev. Rul. 84-17, 1984-1 C.B. 308

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