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## Current Status of U.S. Tax Treaties

*by H. David Rosenbloom\**

It is very difficult for me to think of a more timely conference because, in my corner of the Treasury Department, we have Canada very much on our minds these days. After nearly a decade of negotiations, there is reason to believe that a new income tax convention between the United States and Canada may be in sight. Certainly, all the indications are there. The treaty negotiators are showing signs of fatigue. There have been frequent meetings, calls, and conferences between Canadian and U.S. officials. There have been more and more inquiries from outside sources, including Congressional inquiries seeking information concerning Executive Branch action in this area. In addition, U.S. Treasury Department representatives have emphasized publicly that there are indications that a treaty may be agreed upon.

If we do achieve a new treaty between the United States and Canada, it would very likely be one of the more important and sophisticated fiscal documents in the world. There are extraordinarily close relations between the two countries. The number of persons affected by the treaty would be larger than the number affected by any other treaty in the world. The amount of money affected would probably be larger as well.

So too, the geography creates unusual issues. We spent a long time in negotiations adapting international transport principles to motor vehicles and railroads, which we need not do with most other countries. Furthermore, each of the tax systems in question is both complex and well known to the negotiators of the other side, so that negotiations have assumed a degree of detail and complexity that, in my experience in the Treasury, I have not found elsewhere.

If we do achieve a new treaty, the following will represent some kind of advanced warning. In light of my comments upon the unusual nature of the negotiations, I would not look for a document identical to the OECD† model. There are going to be some unorthodox provisions and some complicated provisions.

The negotiators will miss some things. There will be some provisions which will not work correctly. I think, however, there is general recognition on both sides that the 1942 convention, under which we are presently operating, is badly out of date and that there is a definite need for a fresh start in our fiscal relationship.

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\* International Tax Counsel, U.S. Department of Treasury, Washington, D.C., 1978-1981.

† Organization for Economic Cooperation and Development.

Years have been spent negotiating, and there is a recognition by both sides that we should put together the best package that we can. At the same time there is a dark side. The treaty will be controversial. It will be the subject of intense political debate on both sides of the border. We are not going to please everyone. Particularly on the U.S. side, the treaty program in general has been subject to increasing Congressional scrutiny. There is a suspicion, fed to a large extent by the debate over the new treaty between the United States and the United Kingdom, that tax treaties are somehow illegitimate. Although treaties change U.S. law, they are not drafted, as we all know the Internal Revenue Code is drafted, by the people's representatives in Congress. They are not even reviewed by the tax-writing committees.

On Tuesday of next week, I and others will be testifying in regard to the U.S. tax treaty program. My office has spent a good deal of time preparing for the testimony because we believe that a tax treaty program is essentially a very good thing which should be preserved—improved, of course—but preserved.

I believe it is in the interest of a group such as this to think carefully about what the world would look like in the absence of tax treaties or, for that matter, if the achievement of a tax treaty were impeded to a significantly greater extent than it presently is. That is really the ax that I want to grind here today: in favor of the tax treaty program which I think stands in jeopardy. Having ground that ax, albeit briefly, I can pass to the subject that Henry King really wanted me to talk about, which has nothing to do specifically with the United States-Canada treaty or the problems of the tax treaty program in general, but rather the specific tax treaties negotiations that are currently in process.

Essentially, there are three strands to the present management of the U.S. tax treaty program. The first, not necessarily the most important, is the effort to update and improve existing treaties. I suppose the Canadian situation is a good example of that effort, but there are a number of others. I will try to say a word about each of them.

We have negotiations started with Austria for the purpose of revising our existing income tax treaty with that country. Most of the treaties that were negotiated before the Foreign Investors Tax Act of 1966 are outmoded. The Austrian treaty is an example.

We are negotiating with Belgium, largely at the instance of American companies who seek a lower withholding tax. Belgium is interested in obtaining concessions from the United States.

We have been negotiating with Germany for some time and have issued a position paper outlining the reasons why we are negotiating. We have held several negotiating sessions with the Germans and another one is planned for later in the year.

We are now on the verge of signing a new income tax treaty with Denmark, which will be forwarded to the Senate in due course. We are also on the verge of completing a protocol to our treaty with Norway. The

protocol deals largely with activities in the North Sea.

We are in the process of renegotiating our treaty with Trinidad at the request of the Trinidad Government, basically to cover matters of oil taxation. There are, however, some other matters as well.

We even have a protocol largely negotiated with the U.S.S.R.

We have very advanced negotiations with two significant countries where there is a substantial U.S. investment, Italy and Australia. In the case of Australia, the treaty has been delayed for a substantial period because of differences over the content of the nondiscrimination clause. In the case of Italy, the negotiations are being delayed by essentially administrative matters. We have experienced difficulty due to changes in personnel on both sides. But that treaty should and can be updated.

Finally, in this category of the updating and improving of existing treaties, I would mention virtually all the U.S. estate tax treaties, most of which were largely made obsolete by the integration of the estate and gift taxes undertaken in the United States in 1976.

A second aspect of the tax treaty program concerns certain treaties which are causing serious problems for the U.S. tax system. These are basically extensions of developed countries' treaties to former territories of the treaty partner, some of which have since become independent. I think it is no secret that the Treasury is desirous of renegotiating our treaty relationship with the Netherlands Antilles, for example. We also want to renegotiate or terminate our treaty relationships with a number of former British territories. Perhaps the leading examples are the British Virgin Islands, Barbados, and Antigua.

Nor is it only extensions of former treaties that fall into this category. The United States has recently instituted renegotiation of its treaty with Switzerland. We are concerned that that treaty is not functioning properly, not only with respect to investment in the United States by residents of Switzerland but also with respect to the fairly substantial U.S. direct investment in Switzerland.

In addition, a country that is very much on our mind, but with which we have not yet instituted negotiations, is the Netherlands. It appears that, for some time now, the Netherlands treaty has been used to achieve results that we probably would not countenance under present treaty policy.

A third strand of the treaty program is the effort to extend the U.S. treaty network to more countries of the developing world. If you put aside the extension of treaties with developed countries to territories and former territories of those countries, the United States has in existence only a few treaties with developing countries: the treaty with Pakistan, which dates from 1957; the treaty with Trinidad, from 1970; and the treaty with Korea, which only went into effect recently.

It is fairly difficult to extend the treaty network to developing countries. The consistent policy of the United States in recent years has been not to use tax treaties to create incentives for U.S. investment in treaty

countries. As of the present, we are not contemplating changing this policy. We are, however, trying as best we can to introduce into U.S. negotiations with developing countries a measure of flexibility. We emphasize the desirability from the standpoint of those countries of having a treaty with the United States and try to limit the revenue cost to such countries of having a treaty relationship with the United States.

There are a fair number of pending treaties in this category. The Philippines treaty has been in the Foreign Relations Committee since 1976. That treaty has been objected to by U.S. airlines because of what it does not contain, an exemption for airline profits which, in our view, is probably unobtainable. A very damaging precedent would be set by the idea that a single group of taxpayers can prevent a treaty from being ratified.

A treaty with Morocco is also pending. Morocco is a significant country to the United States from both a political and business standpoint. We are hopeful that that treaty will be taken up at an early date. We have just sent to the Foreign Relations Committee two long-standing treaties, that is to say, treaties which date from many years back, which we have recently concluded with Cyprus and Malta. Neither treaty is terribly significant from the standpoint of U.S. investment, but both add to the treaty network and, generally speaking, it is helpful to have a greater number of treaties with developing countries.

A more significant developing country treaty in process is the one with Jamaica. The new treaty represents an effort to achieve a sort of model for the developing world, at least the Caribbean world. That treaty will be signed on May 21, 1980.

In addition, there are treaties in the works with Bangladesh, Argentina, Egypt, Israel, Indonesia, and Tunisia. Each of these treaties has its own story and each of them, I suppose, has its own constituency.

In the case of Bangladesh, the treaty diverges from the U.S. model by allowing a certain amount of taxation of shipping income in the state of source. In the case of Argentina, a very significant country from the standpoint of the United States, the treaty seeks to mesh a source basis system with the U.S. system; this has required some unusual provisions. The treaties with Egypt and Israel, which went to the Foreign Relations Committee in 1975, have been changed. A protocol to the treaty with Israel has been negotiated and is being translated. A completely new treaty with Egypt has been negotiated, but there is still one minor problem.

Apart from these treaties, we expect to have negotiations with Brazil in August. We have undertaken negotiations with Nigeria, which terminated a treaty with the United States last year, and we are hopeful that the day will come in the not too distant future when negotiations with Mexico will be possible. In this category, as well, is a treaty with a developed country that is nearly negotiated but has never quite been brought to a conclusion—the treaty with Spain.

A further effort in regard to extending the U.S. treaty network is the group of estate and gift tax treaty negotiations that are under way. I mentioned that most of the estate tax treaties are out of date. We are very advanced in estate and gift tax treaty negotiations with Germany, Austria, and Denmark, all inheritance tax jurisdictions whose laws give rise to a number of clear problems of double taxation.

In short, there is a lot going on with the U.S. tax treaty program today, and since it has been our experience that negotiations of this nature lead to further negotiations, I would expect the program to remain active, with or without a new treaty with Canada, for several years to come.

It is, however, in the nature of the modern world that a tax treaty cannot be negotiated and allowed to sit. Particularly where commercial relations are substantial, the treaty partners must return periodically to the product of their negotiations to ensure that what they have written works well in practice. Therefore, I foresee that most of today's major treaties will be reviewed on a more or less regular basis to ensure that the original negotiations operate effectively and that terms of the treaty are changed when and if events so require.

In this regard, I think that it is a fact of some significance for the field of tax treaties that the United States and the United Kingdom have recently scheduled a meeting in July to review the treaty that goes into effect today and to discuss whether a fourth protocol to that treaty is warranted.

That is all I wanted to say about the treaty program. I would be happy to answer any questions about the treaties or any other international tax law subject that would be of interest to you.