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TAXATION CONVENTION WITH THAILAND

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Mr. Helms, from the Committee on Foreign Relations, submitted the following

REPORT

[To accompany Treaty Doc. 105–2]

The Committee on Foreign Relations, to which was referred the Convention between the Government of the United States of America and the Government of the Kingdom of Thailand for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, signed at Bangkok, November 26, 1996, having considered the same, reports favorably thereon, with one declaration and one proviso, and recommends that the Senate give its advice and consent to ratification thereof, as set forth in this report and the accompanying resolution of ratification.

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I. Purpose

The principal purposes of the proposed income tax treaty between the United States and Thailand are to reduce or eliminate double taxation of income earned by residents of either country from sources within the other country and to prevent avoidance or evasion of the income taxes of the two countries. The proposed treaty is intended to promote close economic cooperation and facilitate trade and investment between the two countries. It also is intended to enable the two countries to cooperate in preventing avoidance and evasion of taxes.

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II. Background

The proposed treaty was signed on November 26, 1996. No income tax treaty between the United States and Thailand is in force at present.

The proposed treaty was transmitted to the Senate for advice and consent to its ratification on January 28, 1997 (see Treaty Doc. 105–2). The Committee on Foreign Relations held a public hearing on the proposed treaty on October 7, 1997.

III. Summary

The proposed treaty is similar to other recent U.S. income tax treaties, the 1996 U.S. model income tax treaty ("U.S. model"),[1] the 1992 model income tax treaty of the Organization for Economic Cooperation and Development ("OECD model"), and the 1980 United Nations Model Double Taxation Convention between Developed and Developing Countries ("U.N. model"). However, the proposed treaty contains certain substantive deviations from those treaties and models.

As in other U.S. tax treaties, the proposed treaty's objective of reducing or eliminating double taxation principally is achieved through each country's agreement to limit, in certain specified situations, its right to tax income derived from its territory by residents of the other country. For example, the proposed treaty contains provisions under which each country generally agrees not to tax business income derived from sources within that country by residents of the other country unless the business activities in the taxing country are substantial enough to constitute a permanent establishment or fixed base (Articles 7 and 15). Similarly, the proposed treaty contains "commercial visitor" exemptions under which residents of one country performing personal services in the other country will not be required to pay tax in the other country unless their contact with the other country exceeds specified minimums (Articles 15, 16, and 19). The proposed treaty provides that dividends, interest, royalties, and capital gains derived by a resident of either country from sources within the other country generally may be taxed by both countries (Articles 10, 11, 12, and 13); however, the rate of tax that the source country may impose on a resident of the other country on dividends, interest, and royalties generally will be limited by the proposed treaty (Articles 10, 11, and 12).

In situations where the country of source retains the right under the proposed treaty to tax income derived by residents of the other country, the proposed treaty generally provides for relief from the potential double taxation through the allowance by the country of residence of a tax credit for certain foreign taxes paid to the other country (Article 25).

The proposed treaty contains the standard provision (the "saving clause") included in U.S. tax treaties pursuant to which each country retains the right to tax its residents and citizens as if the treaty had not come into effect (Article 1). In addition, the proposed treaty

[1] The Treasury Department released the U.S. model on September 20, 1996. A 1981 U.S. model treaty was withdrawn by the Treasury Department on July 17, 1992.

contains the standard provision providing that the treaty may not be applied to deny any taxpayer any benefits the taxpayer would be entitled to under the domestic law of a country or under any other agreement between the two countries (Article 1).

The proposed treaty also contains a detailed limitation on benefits provision to prevent the inappropriate use of the treaty (Article 18).

IV. Entry Into Force and Termination

A. ENTRY INTO FORCE

The proposed treaty provides that the instruments of ratification are to be exchanged as soon as possible. The proposed treaty will enter into force on the date the instruments of ratification are exchanged. With respect to taxes withheld at source, the proposed treaty will be effective for amounts paid or credited on or after the first day of the sixth month following the date on which the proposed treaty enters into force. With respect to other taxes, the proposed treaty will be effective for taxable periods beginning on or after the first of January following the date on which the proposed treaty enters into force.

B. TERMINATION

The proposed treaty will continue in force until terminated by either country. Either country may terminate the proposed treaty at any time after the expiration of the five-year period from the date of its entry into force, provided that at least six months prior notice of termination has been given through diplomatic channels. A termination is effective, with respect to taxes withheld at source, for amounts paid or credited on or after the first of January following the expiration of the six-month period. In the case of other taxes, a termination is effective for taxable periods beginning on or after the first of January following the expiration of the six-month period.

Notwithstanding the above rules, the proposed treaty will terminate on January 1 of the sixth year following its entry into force, unless the U.S. Government has received from the Thai Government by the preceding June 30th a diplomatic note indicating that Thailand is prepared to implement the provision of the exchange of information article relating to obtaining information upon request of the other country.

V. Committee Action

The Committee on Foreign Relations held a public hearing on the proposed treaty with Thailand (Treaty Doc. 105–2), as well as on other proposed tax treaties and protocols, on October 7, 1997. The hearing was chaired by Senator Hagel. The Committee considered these proposed treaties and protocols on October 8, 1997, and ordered the proposed treaty with Thailand favorably reported by a voice vote, with the recommendation that the Senate give its advice and consent to ratification of the proposed treaty, subject to a declaration and a proviso.

VI. Committee Comments

On balance, the Committee on Foreign Relations believes that the proposed treaty with Thailand is in the interest of the United States and urges that the Senate act promptly to give advice and consent to ratification. The Committee has taken note of certain issues raised by the proposed treaty, and believes that the following comments may be useful to Treasury Department officials in providing guidance on these matters should they arise in the course of future treaty negotiations.

A. TREATMENT OF REIT DIVIDENDS

REITs in general

Real Estate Investment Trusts ("REITs") essentially are treated as conduits for U.S. tax purposes. The income of a REIT generally is not taxed at the entity level but is distributed and taxed only at the investor level. This single level of tax on REIT income is in contrast to other corporations, the income of which is subject to tax at the corporate level and is taxed again at the shareholder level upon distribution as a dividend. Hence, a REIT is like a mutual fund that invests in qualified real estate assets.

An entity that qualifies as a REIT is taxable as a corporation. However, unlike other corporations, a REIT is allowed a deduction for dividends paid to its shareholders. Accordingly, income that is distributed by a REIT to its shareholders is not subject to corporate tax at the REIT level. A REIT is subject to corporate tax only on any income that it does not distribute currently to its shareholders. As discussed below, a REIT is required to distribute on a current basis the bulk of its income each year.

In order to qualify as a REIT, an entity must satisfy, on a year-by-year basis, specific requirements with respect to its organizational structure, the nature of its assets, the source of its income, and the distribution of its income. These requirements are intended to ensure that the benefits of REIT status are accorded only to pooling of investment arrangements, the income of which is derived from passive investments in real estate and is distributed to the investors on a current basis.

In order to satisfy the organizational structure requirements for REIT status, a REIT must have at least 100 shareholders and not more than 50 percent (by value) of its shares may be owned by five or fewer individuals. In addition, shares of a REIT must be transferrable.

In order to satisfy the asset requirements for REIT status, a REIT must have at least 75 percent of the value of its assets invested in real estate, cash and cash items, and government securities. In addition, diversification rules apply to the REIT's investment in assets other than the foregoing qualifying assets. Under these rules, not more than 5 percent of the value of its assets may be invested in securities of a single issuer and any such securities held may not represent more than 10 percent of the voting securities of the issuer.

In order to satisfy the source of income requirements, at least 95 percent of the gross income of the REIT generally must be from certain passive sources (e.g., dividends, interest, and rents). In ad-

dition, at least 75 percent of its gross income generally must be from certain real estate sources (e.g., real property rents, mortgage interest, and real property gains).

Finally, in order to satisfy the distribution of income requirement, the REIT generally is required to distribute to its shareholders each year at least 95 percent of its taxable income for the year (excluding net capital gains). A REIT may retain 5 percent or less of its taxable income and all or part of its net capital gain.

A REIT is subject to corporate-level tax only on any taxable income and net capital gains that the REIT retains. Under an available election, shareholders may be taxed currently on the undistributed capital gains of a REIT, with the shareholder entitled to a credit for the tax paid by the REIT with respect to the undistributed capital gains such that the gains are subject only to a single level of tax. Distributions from a REIT of ordinary income are taxable to the shareholders as a dividend, in the same manner as dividends from an ordinary corporation. Accordingly, such dividends are subject to tax at a maximum rate of 39.6 percent in the case of individuals and 35 percent in the case of corporations. In addition, capital gains of a REIT distributed as a capital gain dividend are taxable to the shareholders as capital gain. Capital gain dividends received by an individual will be eligible for preferential capital gain tax rates if the relevant holding period requirements are satisfied.

Foreign investors in REITs

Nonresident alien individuals and foreign corporations (collectively, foreign persons) are subject to U.S. tax on income that is effectively connected with the foreign person's conduct of a trade or business in the United States, in the same manner and at the same graduated tax rates as U.S. persons. In addition, foreign persons generally are subject to U.S. tax at a flat 30-percent rate on certain gross income that is derived from U.S. sources and that is not effectively connected with a U.S. trade or business. The 30-percent tax applies on a gross basis to U.S.-source interest, dividends, rents, royalties, and other similar types of income. This tax generally is collected by means of withholding by the person making the payment of such amounts to a foreign person.

Capital gains of a nonresident alien individual that are not connected with a U.S. business generally are subject to the 30-percent withholding tax only if the individual is present in the United States for 183 days or more during the year. The United States generally does not tax foreign corporations on capital gains that are not connected with a U.S. trade or business. However, foreign persons generally are subject to U.S. tax on any gain from a disposition of an interest in U.S. real property at the same rates that apply to similar income received by U.S. persons. Therefore, a foreign person that has capital gains with respect to U.S. real estate is subject to U.S. tax on such gains in the same manner as a U.S. person. For this purpose, a distribution by a REIT to a foreign shareholder that is attributable to gain from a disposition of U.S. real property by the REIT is treated as gain recognized by such shareholder from the disposition of U.S. real property.

U.S. income tax treaties contain provisions limiting the amount of income tax that may be imposed by one country on residents of the other country. Many treaties, like the proposed treaty, generally allow the source country to impose not more than a 15-percent withholding tax on dividends paid to a resident of the other treaty country. In the case of real estate income, most treaties specify that income derived from, and gain from dispositions of, real property in one country may be taxed by the country in which the real property is situated without limitation.[2] Accordingly, U.S. real property rental income derived by a resident of a treaty partner generally is subject to the U.S. withholding tax at the full 30-percent rate (unless the net-basis taxation election is made), and U.S. real property gains of a treaty partner resident are subject to U.S. tax in the manner and at the rates applicable to U.S. persons.

Although REITs are not subject to corporate-level taxation like other corporations, distributions of a REIT's income to its shareholders generally are treated as dividends in the same manner as distributions from other corporations. Accordingly, in cases where no treaty is applicable, a foreign shareholder of a REIT is subject to the U.S. 30-percent withholding tax on ordinary income distributions from the REIT. In addition, such shareholders are subject to U.S. tax on U.S. real estate capital gain distributions from a REIT in the same manner as a U.S. person.

In cases where a treaty is applicable, this U.S. tax on capital gain distributions from a REIT still applies. However, absent special rules applicable to REIT dividends, treaty provisions specifying reduced rates of tax on dividends apply to ordinary income dividends from REITs as well as to dividends from taxable corporations. As discussed above, the proposed treaty, like many U.S. treaties, reduces the U.S. 30-percent withholding tax to 15 percent in the case of dividends generally. Prior to 1989, U.S. tax treaties contained no special rules excluding dividends from REITs from these reduced rates. Therefore, under pre-1989 treaties, REIT dividends are eligible for the same reductions in the U.S. withholding tax that apply to other corporate dividends.

Beginning in 1989, U.S. treaty negotiators began including in treaties provisions excluding REIT dividends from the reduced rates of withholding tax generally applicable to dividends. Under treaties with these provisions such as the proposed treaty, REIT dividends generally are subject to the full U.S. 30-percent withholding tax.[3]

Analysis of treaty treatment of REIT dividends

The specific treaty provisions governing REIT dividends were introduced beginning in 1989 because of concerns that the reductions in withholding tax generally applicable to dividends were inappro-

[2] Many treaties allow the foreign person to elect to be taxed in the source country on income derived from real property on a net basis under the source country's domestic laws. The proposed treaty provides that income derived from real property may be taxed by the country in which the real property is situated. Although the proposed treaty does not specify a rule for gains from the disposition of real property, under the proposed treaty such gains may be taxed in the country in which the property is located according to the internal law of that country.

[3] Many treaties provide a maximum tax rate of 15 percent in the case of REIT dividends beneficially owned by an individual who holds a less than 10 percent interest in the REIT. The proposed treaty provides that individuals who hold a less than 25 percent interest in a REIT qualify for the 15-percent dividend rate.

priate in the case of dividends from REITs. The reductions in the rates of source-country tax on dividends reflect the view that the full 30-percent withholding tax rate may represent an excessive rate of source-country taxation where the source country already has imposed a corporate-level tax on the income prior to its distribution to the shareholders in the form of a dividend. In the case of dividends from a REIT, however, the income generally is not subject to corporate-level taxation.

REITs are required to distribute their income to their shareholders on a current basis. The assets of a REIT consist primarily of passive real estate investments and the REIT's income may consist principally of rentals from such real estate holdings. U.S.-source rental income generally is subject to the U.S. 30-percent withholding tax. Moreover, the United States's treaty policy is to preserve its right to tax real property income derived from the United States. Accordingly, the U.S. 30-percent tax on rental income from U.S. real property is not reduced in U.S. tax treaties.

If a foreign investor in a REIT were instead to invest in U.S. real estate directly, the foreign investor would be subject to the full 30-percent withholding tax on rental income earned on such property (unless the net-basis taxation election is made). However, when the investor makes such investments through a REIT instead of directly, the income earned by the investor is treated as dividend income. If the reduced rates of withholding tax for dividends apply to REIT dividends, the foreign investor in the REIT is accorded a reduction in U.S. withholding tax that is not available for direct investments in real estate.

On the other hand, some argue that it is important to encourage foreign investment in U.S. real estate through REITs. In this regard, a higher withholding tax on REIT dividends (i.e., 30 percent instead of 15 percent) may not be fully creditable in the foreign investor's home country and the cost of the higher withholding tax therefore may discourage foreign investment in REITs. For this reason, some oppose the inclusion in U.S. treaties of the special provisions governing REIT dividends, arguing that dividends from REITs should be given the same treatment as dividends from other corporate entities. Accordingly, under this view, the 15-percent withholding tax rate generally applicable under treaties to dividends should apply to REIT dividends as well.

This argument is premised on the view that investment in a REIT is not equivalent to direct investment in real property. From this perspective, an investment in a REIT should be viewed as comparable to other investments in corporate stock. In this regard, like other corporate shareholders, REIT investors are investing in the management of the REIT and not just its underlying assets. Moreover, because the interests in a REIT are widely held and the REIT itself typically holds a large and diversified asset portfolio, an investment in a REIT represents a very small investment in each of a large number of properties. Thus, the REIT investment provides diversification and risk reduction that are not easily replicated through direct investment in real estate.

At the October 7, 1997 hearing on the proposed treaty (as well as other proposed treaties and protocols), the Treasury Department announced that it has modified its policy with respect to the exclu-

sion of REIT dividends from the reduced withholding tax rates applicable to other dividends under treaties. The Treasury Department worked extensively with the staff of the Committee on Foreign Relations, the staff of the Joint Committee on Taxation, and representatives of the REIT industry in order to address the concern that the current treaty policy with respect to REIT dividends may discourage some foreign investment in REITs while maintaining a treaty policy that properly preserves the U.S. taxing jurisdiction over foreign direct investment in U.S. real property. The new policy is a result of significant cooperation among all parties to balance these competing considerations.

Under this policy, REIT dividends paid to a resident of a treaty country will be eligible for the reduced rate of withholding tax applicable to portfolio dividends (typically, 15 percent) in two cases. First, the reduced withholding tax rate will apply to REIT dividends if the treaty country resident beneficially holds an interest of 5 percent or less in each class of the REIT's stock and such dividends are paid with respect to a class of the REIT's stock that is publicly traded. Second, the reduced withholding tax rate will apply to REIT dividends if the treaty country resident beneficially holds an interest of 10 percent or less in the REIT and the REIT is diversified, regardless of whether the REIT's stock is publicly traded. In addition, the current treaty policy with respect to the application of the reduced withholding tax rate to REIT dividends paid to individuals holding less than a specified interest in the REIT will remain unchanged.

For purposes of these rules, a REIT will be considered diversified if the value of no single interest in real property held by the REIT exceeds 10 percent of the value of the REIT's total interests in real property. An interest in real property will not include a mortgage, unless the mortgage has substantial equity components. An interest in real property also will not include foreclosure property. Accordingly, a REIT that holds exclusively mortgages will be considered to be diversified. The diversification rule will be applied by looking through a partnership interest held by a REIT to the underlying interests in real property held by the partnership. Finally, the reduced withholding tax rate will apply to a REIT dividend if the REIT's trustees or directors make a good faith determination that the diversification requirement is satisfied as of the date the dividend is declared.

The Treasury Department will incorporate this new policy with respect to the treatment of REIT dividends in the U.S. model treaty and in future treaty negotiations.

The Committee believes that the new policy with respect to the applicability of reduced withholding tax rates to REIT dividends appropriately reflects economic changes since the establishment of the current policy. The Committee further believes that the new policy fairly balances competing considerations by extending the reduced rate of withholding tax on dividends generally to dividends paid by REITs that are relatively widely-held and diversified. The Committee anticipates that incorporation of this new policy will be considered in connection with any future modification to the proposed treaty.

B. DEVELOPING COUNTRY CONCESSIONS

The proposed treaty contains a number of developing country concessions, some of which are found in other U.S. income tax treaties with developing countries. The most significant of these concessions are described below.

Definition of permanent establishment

The proposed treaty departs from the U.S. and OECD models by providing for broader source-basis taxation with respect to business activities of residents of the other country. The proposed treaty's permanent establishment article, for example, permits the country in which business activities are carried on to tax the activities in circumstances where it would not be able to do so under the U.S., OECD and U.N. models. Under the proposed treaty, a building site or construction, assembly or installation project, or supervisory activities in connection therewith, or an installation or drilling rig or ship used for the exploration or exploitation of natural resources, constitutes a permanent establishment if the site, project or activities continue in a country for more than 120 days within any 12-month period. For example, under the proposed treaty, a U.S. enterprise's business profits that are attributable to a construction project in Thailand will be taxable by Thailand if the project lasts for more than 120 days within a 12-month period. Under the U.S. and OECD models, such a site or project must last for more than one year in order to constitute a permanent establishment. Under the U.N. model and other U.S. treaties with developing countries, the site or project must last for more than six months in order to constitute a permanent establishment. Thus, the proposed treaty's 120-day period for establishing a permanent establishment is significantly shorter than the corresponding periods in the U.S., OECD and U.N. models.

The proposed treaty contains a provision, not present in either the U.S. model or the OECD model, which deems a permanent establishment to exist where an enterprise provides services through its employees in a country if the activities continue for a period or periods aggregating more than 90 days within any 12-month period. The U.N. model contains a similar rule, but it does not deem a permanent establishment to exist unless the service activities continue for more than six months. Thus, the proposed treaty grants broader taxing rights to the source country than the U.N. model with respect to such service activities. The proposed treaty also deems a permanent establishment to exist where the enterprise provides services through its employees for a related enterprise, regardless of the period of time spent providing such services. This latter rule is not contained in the U.S., OECD or U.N. models.

The proposed treaty contains a provision, not present in either the U.S. model or the OECD model, which expands the circumstances under which activities of agents will give rise to a permanent establishment. Under this provision, an enterprise of one treaty country is treated as having a permanent establishment in the other country if its agent regularly secures orders in a country for the enterprise. A permanent establishment of an enterprise also

is deemed to exist if its agent maintains in the other country a stock of goods or merchandise belonging to the enterprise from which the agent regularly makes deliveries on behalf of the enterprise.

Taxation of business profits

Under the U.S. model and many other U.S. income tax treaties, a country may tax the business profits of a resident of the other country only to the extent those profits are attributable to a permanent establishment situated within the first country. The proposed treaty expands the definition of business profits that are attributable to a permanent establishment to include profits that are derived from sales of goods or merchandise of the same or similar kind as those sold through the permanent establishment, and profits derived from other business activities of the same or similar kind as those effected through the permanent establishment. However, this rule applies only if it is proved that the sale or activities were structured in a manner intended to avoid tax in the country where the permanent establishment is located. This expanded definition is narrower than the rule included in some other U.S. tax treaties with developing countries. It should be noted that although this rule provides for broader source basis taxation than does the rule contained in the U.S. model, it is not as broad as the "force of attraction" rule that is included in the Internal Revenue Code (the "Code").

Taxation of certain equipment leasing

The proposed treaty treats as royalties payments for the use of, or the right to use, industrial, commercial, or scientific equipment. In most other treaties, these payments are considered rental income; as such, the payments are subject to the business profits rules, which generally permit the source country to tax such amounts only if they are attributable to a permanent establishment located in that country, and the payments are taxed, if at all, on a net basis. By contrast, the proposed treaty permits gross-basis source-country taxation of these payments, at a rate not to exceed 8 percent, if the payments are not attributable to a permanent establishment situated in that country. If the payments are attributable to such a permanent establishment, the business profits article of the proposed treaty is applicable.

Other taxation by source country

The proposed treaty includes a number of additional concessions with respect to source basis taxation of amounts earned by residents of the other treaty country.

The proposed treaty allows a maximum rate of source-country tax on dividends of 15 percent (10 percent if the beneficial owner of the dividend is a company that owns at least 10 percent of the voting shares of the payor). These maximum rates on dividends are higher than those provided in either the U.S. model or the OECD model.

The proposed treaty allows a maximum rate of source-country tax on interest of 15 percent (10 percent in the case of interest beneficially owned by a financial institution, or by a resident of a coun-

try and paid with respect to indebtedness arising from credit sales of equipment, merchandise or services). The proposed treaty provides an exemption from source-country tax for interest paid to the government of each country and to certain governmental entities. By contrast, the U.S. model generally would not permit source-country taxation of interest. Moreover, the maximum rate permitted under the proposed treaty is higher than the maximum rate provided in the OECD model.

The proposed treaty allows a maximum rate of source-country tax on royalties of 5, 8, or 15 percent, depending on the type of property involved. The 5-percent limitation applies to payments for the use of, or the right to use, any copyright of literary, artistic or scientific work, including software, and motion pictures and works on film, tape or other means of reproduction for use in connection with radio or television broadcasting. The 8-percent limitation applies to payments for the use of, or the right to use, industrial, commercial or scientific equipment. The 15-percent limitation applies to payments of any kind for the use of, or the right to use, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience. By contrast, both the U.S. model and the OECD model generally would not permit source-country taxation of royalties.

The proposed treaty permits source-country taxation of income derived by a resident of the other treaty country from professional or other independent services if the resident is present in the source country for the purpose of performing such services for 90 days or more in the taxable year concerned. By contrast, the U.S. and OECD models generally would permit source-country taxation of income from independent personal services only where such income is attributable to a fixed base or permanent establishment in the source country. The U.N. model contains a similar rule as the proposed treaty, but does not deem a permanent establishment to exist unless the resident is present in the source country for the purpose of performing independent professional services for more than 183 days in the taxable year concerned. Thus, the proposed treaty grants broader taxing rights to the source country than the U.N. model with respect to such professional services. The proposed treaty also allows source-country taxation if the remuneration for an individual's activities in a country is paid by a resident of that country, or is borne by a permanent establishment or fixed base in that country, and the remuneration exceeds $10,000. This latter rule is not contained in the U.S. or OECD models.

The proposed treaty generally permits source-country taxation of artistes and sportsmen if the gross receipts derived by the individual in the source country exceed the lesser of $100 per day or $3,000 in the aggregate for the taxable year concerned. By contrast, the U.S. model generally would permit source-country taxation of artistes and sportsmen only if the gross receipts (including reimbursed expenses) exceed $20,000.

The proposed treaty permits source-country taxation under Article 24 (Other Income) for income of a resident of a country that is not dealt with in other articles of the proposed treaty. Under the proposed treaty, such income may also be taxed by the recipient's

country of residence. By contrast, the U.S. and OECD models generally would permit only a recipient's country of residence to tax such other income.

Committee conclusions

One purpose of the proposed treaty is to reduce tax barriers to direct investment by U.S. firms in Thailand. The practical effect of these developing country concessions could be greater Thai taxation of future activities of U.S. firms in Thailand than would be the case under the rules of either the U.S. or OECD model treaties.

There is a risk that the inclusion of these developing country concessions in the proposed treaty could result in additional pressure on the United States to include them in future treaties negotiated with developing countries. However, these precedents already exist in the U.N. model, and a number of existing U.S. income tax treaties with developing countries already include similar concessions. Such concessions arguably are necessary in order to obtain treaties with developing countries. Tax treaties with developing countries can be in the interest of the United States because they provide developing country tax relief for U.S. investors and a clearer framework within which the taxation of U.S. investors will take place.

As part of its consideration of the proposed treaty, the Committee asked the Treasury Department about the appropriateness of the developing country concessions granted to Thailand in the proposed treaty. The relevant portion of the Treasury Department's October 8, 1997 letter [4] responding to this inquiry is reproduced below:

> Regarding whether Thailand is an appropriate recipient of developing country concessions, it should be noted that for 1995, Thailand's gross domestic product (GDP) was $416.7 billion and its per capita GDP was $6,900. By contrast, the United States' 1995 GDP was $7.2 trillion and its per capita GDP was $27,500.
>
> . . . Entering into a tax treaty with Thailand is a very high priority in the U.S. business community. Without a treaty, U.S. businesses are at a competitive disadvantage in Thailand, since most of their competitors invest from countries that have already concluded tax treaties with Thailand. Also, this treaty is a step toward expansion of our tax treaty network in Asia. Entering into this treaty with Thailand will facilitate negotiating treaties with other important countries in the region. Thus, we think the concessions are appropriate, both because of the economic position of Thailand as a developing nation and because of the benefits that will accrue to the United States.

The Committee accepts the Treasury Department's assessment of Thailand as a developing country. However, the Committee is concerned that developing country concessions not be viewed as the starting point for future negotiations with developing countries. It must be clearly recognized that several of the rules of the proposed treaty represent substantial concessions by the United States, and that such concessions must be met with substantial concessions by the treaty partner. Thus, future negotiations with developing countries should not assume, for example, that the definition of permanent establishment provided in this treaty necessarily will be available in every case; rather, such a definition will be only adopted

[4] Letter from Joseph H. Guttentag, International Tax Counsel, Treasury Department, to Senator Paul Sarbanes, Committee on Foreign Relations, October 8, 1997 ("October 8, 1997 Treasury Department letter").

in the context of an agreement that satisfactorily addresses the concerns of the United States.

C. GAINS

The proposed treaty contains a broad rule under which both treaty countries generally may tax gains from the alienation of property in accordance with its internal law. This represents a departure from the U.S. and OECD models and most other U.S. treaties, which generally provide that gains are permitted to be taxed only in the country of residence (with specified exceptions for gains with respect to real property interests or with respect to a permanent establishment or fixed base).

Under current Thai law, only gains from the disposal of shares in a Thai company by a foreign corporation are subject to Thai tax. The provision in the proposed treaty, however, is drafted broadly and, thus, would allow Thailand to impose a tax in the future on gains from the alienation of other types of property. The United States generally does not tax nonresident individuals and foreign corporations on capital gains, other than gains with respect to a U.S. real property interest, unless such gains are effectively connected with a U.S. trade or business.

Under current Thai law, the provision creates the potential for double taxation of the gains derived by a U.S. corporation from the alienation of shares in a Thai company. U.S. internal law generally would treat gains realized by a U.S. person from the disposition of shares issued by a foreign corporation as U.S.-source income. The U.S. foreign tax credit rules permit foreign taxes to offset only U.S. taxes on foreign-source income. Under these rules, the Thai taxes paid on such gains could not be used to offset the U.S. taxes paid on the same gains. The potential double taxation would have to be referred to the competent authorities of the two countries for possible relief.

The provision contained in the proposed treaty is not found in the U.S. or OECD models. Although Thailand's right to tax such gains is limited under current Thai law to certain stock gains, the provision is drafted broadly to cover any future gains that Thailand might tax on the alienation of other types of property. This provision should not stand as a model for other treaty negotiations. Moreover, in negotiating future tax treaties, the Treasury Department should continue to seek provisions that conform more closely to the U.S. model in generally providing for exclusive residence-country taxation of gains (other than gains on real property).

D. SHIPPING, AIRCRAFT AND CONTAINER INCOME

Income from the operation of ships and aircraft

The proposed treaty treats income from the operation of ships differently than income from the operation of aircraft. Under the proposed treaty, income derived by a resident of a treaty country from the operation of aircraft in international traffic is taxable only in that country, regardless of whether the resident maintains a permanent establishment in the other country. Unlike the U.S. model and most U.S. tax treaties, an enterprise that engages in the operation of ships in international traffic would not be eligible for

the rule limiting the right to tax income from operations in international traffic to the enterprise's country of residence. Rather, the proposed treaty provides limited source-country taxation of income from the operation of ships in international traffic. In this regard, the proposed treaty provides that the amount of tax imposed by a treaty country on income or profits derived by a resident of the other country from the operation of ships in international traffic is reduced to 50 percent of the amount which would have been imposed in the absence of the proposed treaty. Thus, the amount of Thai tax that may be imposed on income or profits derived by a U.S. resident from the operation of ships in international traffic is equal to 50 percent of the tax imposed on such income under Thai internal law. Under Thai law, a 3 percent tax is imposed on fees from the shipment or carriage of goods from Thailand, and on fees from the carriage of passengers that are collectible or collected in Thailand; the Thai tax does not apply to the shipment or carriage of goods into Thailand, or to fees from the carriage of passengers that are collectible and collected outside Thailand. Thus, under the proposed treaty, U.S. residents would be subject to a 1.5 percent Thai tax with respect to income from the operation of ships in international traffic that is derived from, for example, shipment of goods from Thailand.

Income from the rental of ships, aircraft and containers

Unlike the U.S. model and many U.S. tax treaties, the proposed treaty contains a provision under which income or profits derived from the rental of ships or aircraft will be treated as income from the operation of ships or aircraft in international traffic (and, thus, will be covered by the respective rules described above for income from the operation of ships and aircraft in international traffic), only if the rental profits are incidental to other profits from the operation of ships or aircraft in international traffic. Similarly, the proposed treaty provides that income derived from the rental of containers (including trailers, barges, and related equipment for the transport of containers) will be treated as income from the operation of ships or aircraft in international traffic, only if the rental profits are incidental to other profits from the operation of ships or aircraft in international traffic. The U.S. model and many other treaties provide that profits from the rental of ships, aircraft and containers operated or used in international traffic are taxable only in the country of residence, without requiring that the rental profits be incidental to income of the recipient from the operation of ships or aircraft in international traffic. Under the proposed treaty, unlike under the U.S. model, an enterprise that engages, for example, only in the *rental* of aircraft, but does not engage in the operation of aircraft, would not be eligible for the rule limiting the right to tax income from operations in international traffic to the enterprise's country of residence.

Under the proposed treaty, profits from the rental of ships, aircraft or containers that are *not* incidental to other income from the international operation of ships and aircraft generally would be taxable by the source country as business profits if such profits are attributable to a permanent establishment. This represents a departure from current U.S. treaty policy, which is to treat such non-

incidental rental income as taxable only in the country of residence. Although the treatment in the proposed treaty is not as favorable as the treatment under the U.S. model and most U.S. tax treaties, the proposed treaty's rule may be more favorable than some U.S. treaties which treat such types of "non-incidental" rental income as royalties potentially subject to a gross withholding tax in the source country, regardless of whether such income is attributable to a permanent establishment in the source country.

Committee conclusions

As part of its consideration of the proposed treaty, the Committee asked the Treasury Department whether the treatment of income derived from the operation of ships in international traffic (as compared to income from the operation of aircraft in international traffic), and from the rental of ships, aircraft and containers, is appropriate. The relevant portion of the October 8, 1997 Treasury Department letter responding to this inquiry is reproduced below:

> The provisions of the proposed treaty accommodate Thailand's long-standing and consistently applied treaty policy. In the absence of the treaty, Thailand would impose a tax of 3 percent of gross income from the carriage of goods from Thailand. The treaty will allow income from the international operation of *ships* to be taxed at one-half of the tax rate otherwise applicable. The proposed treaty, consistent with current U.S. treaty policy, exempts U.S. companies from Thai tax on their profits from international carriage by *aircraft.* In addition, the United States and Thailand have agreed that if Thailand grants to any other country more favorable treatment on shipping income than is granted in this proposed treaty, negotiations will be reopened to extend that more favorable treatment to the United States.
>
> Under the proposed treaty, income derived from any trade or business, including profits from the rental of ships, aircraft and containers that are not incidental to income from the operation of ships or aircraft in international traffic, is treated as business profits, and is thus taxable by the state in which the income recipient is not resident only a net basis and only if attributable to a permanent establishment in that state. Current U.S. treaty policy is to treat such non-incidental rental income as taxable only in the state of residence, and its inclusion in the definition of "business profits" is thus a concession by the United States. The current treaty policy of Thailand as reflected in various of their other tax treaties is to include such income in the definition of "royalties": Under the proposed treaty, taxation as royalties would subject the income to a tax of 8 percent of the gross amount. Thus the inclusion of such income in the definition of "business profits" is a concession by Thailand.
>
> We believe the treatment under the proposed treaty of income derived from the operation of ships in international traffic and from the rental of ships, aircraft and containers represents an appropriate compromise between the treaty policies of the United States and Thailand.

The proposed treaty provides for limited source-country taxation of income from the operation of ships in international traffic, representing a departure from the U.S. and OECD models. The diplomatic notes supplementing the proposed treaty provide that if Thailand grants to any other country more favorable treatment on such shipping income than is granted in the proposed treaty, negotiations will be reopened to extend that more favorable treatment to the United States. In the past, the Committee has expressed concern about the anti-competitive effects of a provision, such as the provision in the U.S.–Indonesia treaty, that treats non-incidental income from container leasing as royalty income subject to a source-country withholding tax. The Committee understands that under the proposed treaty non-incidental income derived by a resident of one country from the rental of ships, aircraft and containers would be subject to tax in the other country only if such income is

attributable to a permanent establishment maintained by the resident in the other country. In light of the limited circumstances under which source-country taxation will apply to income from the rental of ships, aircraft and containers, the Committee believes that the provision in the proposed treaty with respect to such non-incidental rental income generally is consistent with the treaty purpose of reducing or eliminating double taxation.

E. ROYALTY SOURCE RULES

Under the proposed treaty, royalties are sourced by reference to where the payor resides (or where the payor has a permanent establishment or fixed base, if the royalty was incurred and borne by the permanent establishment or fixed base). If this rule does not treat the royalty as sourced in one of the treaty countries, the royalty is sourced based on the place of use of the property. This source provision has been included in some other U.S. treaties (e.g., the 1995 U.S.–Canada protocol). However, this source provision is different than the U.S. internal law rule which sources royalties based on the place of use of the property.

Under the proposed treaty, if a Thai resident that does not have a permanent establishment or fixed base in the United States pays a royalty to a U.S. resident for the right to use property exclusively in the United States, the proposed treaty would treat such a royalty as Thai source (and therefore potentially taxable in Thailand). However, U.S. internal law would treaty such a royalty as U.S.-source income. This creates the potential for double taxation of royalty income derived by a U.S. resident. The Committee believes that this situation would arise in relatively few cases (compared to the more common presence of a permanent establishment in the country where the property is used). However, the Committee believes that in negotiating future treaties, the Treasury Department should continue to seek provisions that conform more closely to the U.S. model.

F. EXCHANGE OF INFORMATION

One of the principal purposes of the proposed income tax treaty between the United States and Thailand is to prevent avoidance or evasion of income taxes of the two countries. The exchange of information article of the proposed treaty is one of the primary vehicles used to achieve that purpose.

The exchange of information article contained in the proposed treaty conforms in most respects to the corresponding articles of the U.S. and OECD models. As is true under these model treaties, under the proposed treaty the countries are to exchange such information as is necessary for carrying out the provisions of the proposed treaty or the domestic tax laws of the countries. As is also true under these model treaties, under the proposed treaty a country is not required to carry out administrative measures at variance with the laws and administrative practices of either country, to supply information which is not obtainable under the laws or in the normal course of the administration of either country, or to supply information which discloses any trade, business, industrial, commercial, or professional secret or trade process, or information the disclosure of which is contrary to public policy.

There is one significant respect in which the exchange of information article does not conform to the corresponding article of the U.S. model. Although the proposed treaty includes the standard provision that upon request a country shall obtain information to which the request relates in the same manner and to the same extent as if the tax of the requesting country were imposed by the requested country, the proposed treaty would also suspend the application of this provision until the U.S. receives from Thailand a diplomatic note indicating that Thailand is prepared and able to implement these provisions. The Technical Explanation states that it is understood that Thailand will not be prepared and able to implement these provisions until enabling legislation is enacted in Thailand. This means that neither country will obtain information upon a request of the other until this diplomatic note is provided. [5]

The provision of this diplomatic note also is an important element in the termination article of the proposed treaty. There are two ways in which the proposed treaty can terminate. The first is a voluntary mechanism under which either country can terminate the proposed treaty at any time after five years after it enters into force, provided that appropriate notification is given. The second, which is much more unusual, is a mandatory termination on January 1 of the sixth year following the year the proposed treaty enters into force, unless this diplomatic note is received by the previous June 30th.

As part of its consideration of the proposed treaty, the Committee asked the Treasury Department whether the exchange of information provisions of the proposed treaty are sufficient and whether the termination provision represents an appropriate balancing of incentives and consequences that will achieve the goal of implementing the provisions relating to obtaining information. The relevant portion of the October 8, 1997 Treasury Department letter responding to this inquiry is reproduced below:

> Under the existing Mutual Legal Assistance Treaty between the two countries, Thailand will be able to provide adequate tax information, including bank information, relevant to *criminal* cases that may be pursued by U.S. authorities. In addition, under the proposed treaty and in accordance with present Thai law, Thailand will be able to provide to the United States adequate tax information, including bank information, in any civil case in which there is a Thai tax interest. Under current Thai law, however, Thailand may not be able to provide information under the tax treaty where there is no Thai tax interest. The treaty contains a special provision regarding exchange of information, designed to deal with this "tax interest" problem.
>
> The treaty provides that Thailand generally is required to treat a U.S. tax interest as a Thai tax interest in all cases, including both civil and criminal tax proceedings. However, this general provision will not be in effect for either country until the United States receives from Thailand a diplomatic note indicating that Thailand is both prepared and able to implement this provision, which will not be possible until Thai law is changed. If the United States has not received such a diplomatic note by June 30 of the fifth year following the treaty's entry into force, the entire treaty will terminate on January 1 of the sixth year following its entry into force.

[5] The Letter of Submittal from the Secretary of State to the President states that Thailand may not "provide" information under the proposed treaty until the U.S. receives from Thailand a diplomatic note indicating that Thailand is prepared and able to implement these provisions. It appears that this is necessarily a reference to the provision regarding obtaining information rather than exchanging information already in the possession of Thailand, because the suspension clause in the proposed treaty refers to "this paragraph" (obtaining information), not to "this article." See Treaty Doc. 105–2, page vii.

Although broader exchange of information provisions are desirable, the Committee understands the difficulty in achieving broader provisions given the current constraints of Thai law and practices. Although the termination mechanism in the proposed treaty is not the preferred method for achieving U.S. tax treaty policy, the Committee is assured by the Treasury Department that this termination mechanism will encourage Thailand to change its laws to fully accommodate the United States' goal of implementing the provisions relating to obtaining information. However, the Committee does not believe that the proposed Thai treaty should be construed in any way as a precedent for other treaty negotiations. The exchange of information provisions in treaties are central to the purposes for which tax treaties are entered into, and significant limitations on their effect, relative to the preferred U.S. tax treaty position, should not be accepted in negotiations with other countries that seek to have or to maintain the benefits of a tax treaty relationship with the United States.

G. TREATY SHOPPING

The proposed treaty, like a number of U.S. income tax treaties, generally limits treaty benefits for treaty country residents so that only those residents with a sufficient nexus to a treaty country will receive treaty benefits. Although the proposed treaty is intended to benefit residents of Thailand and the United States only, residents of third countries sometimes attempt to use a treaty to obtain treaty benefits. This is known as "treaty shopping." Investors from countries that do not have tax treaties with the United States, or from countries that have not agreed in their tax treaties with the United States to limit source-country taxation to the same extent that it is limited in another treaty may, for example, attempt to secure a lower rate of tax by lending money to a U.S. person indirectly through a country whose treaty with the United States provides for a lower rate. The third-country investor may do this by establishing in that treaty country a subsidiary, trust, or other investing entity which then makes the loan to the U.S. person and claims the treaty reduction for the interest it receives.

The anti-treaty-shopping provision of the proposed treaty is similar to an anti-treaty-shopping provision in the Code (as interpreted by Treasury regulations), in the U.S. model, and several newer treaties.

One provision of the anti-treaty-shopping article differs from the comparable rule in some earlier U.S. treaties, but the effect of the change is not completely clear. The general test applied by those earlier treaties for the allowance of benefits, short of satisfaction of a bright-line ownership and base erosion test, is a broadly subjective one, looking to whether the acquisition, maintenance, or operation of an entity did not have "as a principal purpose obtaining benefits" under the treaty. By contrast, the proposed treaty contains a more precise test that allows denial of benefits only with respect to income not derived in connection with the active conduct of a trade or business. (However, this active trade or business test generally does not apply with respect to a business of making or managing investments, so benefits can be denied with respect to such a business regardless of how actively it is conducted.) In addi-

tion, the proposed treaty gives the competent authority of the source country the ability to override this standard and to allow benefits if it so determines in its discretion.

The practical difference between the proposed treaty tests and the earlier tests will depend upon how they are interpreted and applied. The principal purpose test may be applied leniently (so that any colorable business purpose suffices to preserve treaty benefits), or it may be applied strictly (so that any significant intent to obtain treaty benefits suffices to deny them). Similarly, the standards in the proposed treaty could be interpreted to require, for example, a more active or a less active trade or business (though the range of interpretation is far narrower). Thus, a narrow reading of the principal purpose test could theoretically be stricter than a broad reading of the proposed treaty tests (i.e., would operate to deny benefits in potentially abusive situations more often).

The Committee believes that limitation on benefits provisions are important to protect against "treaty shopping" by limiting benefits of a treaty to bona fide residents of the treaty partner. The Committee further believes that the United States should maintain its policy of limiting treaty shopping opportunities whenever possible. The Committee continues to believe further that, in exercising any latitude Treasury has to adjust the operation of the proposed treaty, the rules as applied should adequately deter treaty shopping abuses. The proposed anti-treaty-shopping provision may be effective in preventing third-country investors from obtaining treaty benefits by establishing investing entities in Thailand since third-country investors may be unwilling to share ownership of such investing entities on a less-than-50-percent basis with U.S. or Thai residents or other qualified owners to meet the ownership test of the anti-treaty-shopping provision. In addition, the base erosion test provides protection from certain potential abuses of a Thai conduit. Finally, Thailand imposes significant taxes of its own; these taxes may deter third-country investors from seeking to use Thai entities to make U.S. investments. On the other hand, implementation of the detailed tests for treaty shopping set forth in the treaty may raise factual, administrative, or other issues that cannot currently be foreseen. The Committee emphasizes that the proposed anti-treaty-shopping provision must be implemented so as to serve as an adequate tool for preventing possible treaty-shopping abuses in the future.

VII. BUDGET IMPACT

The Committee has been informed by the staff of the Joint Committee on Taxation that the proposed treaty is estimated to cause a negligible change in fiscal year Federal budget receipts during the 1998–2007 period.

VIII. EXPLANATION OF PROPOSED TREATY

A detailed, article-by-article explanation of the proposed income tax treaty between the United States and Thailand is set forth below. The understandings set forth in the diplomatic notes exchanged at the time the proposed treaty was signed are covered together with the relevant articles of the proposed treaty.

Article 1. Personal Scope

The proposed treaty generally applies to residents of the United States and to residents of Thailand, with specific modifications to such scope provided in other articles (e.g., Article 21 (Government Service), Article 26 (Non-Discrimination) and Article 28 (Exchange of Information)). This scope generally is consistent with the scope of other U.S. income tax treaties, the U.S. model, the OECD model and the U.N. model. For purposes of the proposed treaty, residence is determined under Article 4 (Residence).

The proposed treaty provides that it does not restrict in any manner any exclusion, exemption, deduction, credit, or other allowance accorded by internal law or by any other agreement between the United States and Thailand. Thus, the proposed treaty will not apply to increase the tax burden of a resident of either the United States or Thailand. According to the Treasury Department's Technical Explanation (hereinafter referred to as the "Technical Explanation"), the fact that the proposed treaty only applies to a taxpayer's benefit does not mean that a taxpayer may select inconsistently among treaty and internal law provisions in order to minimize its overall tax burden. In this regard, the Technical Explanation sets forth the following example. Assume a resident of Thailand has three separate businesses in the United States. One business is profitable and constitutes a U.S. permanent establishment. The other two businesses generate effectively connected income as determined under the Code, but do not constitute permanent establishments as determined under the proposed treaty; one business is profitable and the other business generates a net loss. Under the Code, all three businesses would be subject to U.S. income tax, in which case the losses from the unprofitable business could offset the taxable income from the other businesses. On the other hand, only the income of the business which gives rise to a permanent establishment is taxable by the United States under the proposed treaty. The Technical Explanation makes clear that the taxpayer may not invoke the proposed treaty to exclude the profits of the profitable business that does not constitute a permanent establishment and invoke U.S. internal law to claim the loss of the unprofitable business that does not constitute a permanent establishment to offset the taxable income of the permanent establishment.[6]

Like all U.S. income tax treaties and the U.S. model, the proposed treaty includes a "saving clause." Under this clause, with specific exceptions described below, the proposed treaty does not affect the taxation by either treaty country of its residents or its citizens. By reason of this saving clause, unless otherwise specifically provided in the proposed treaty, the United States will continue to tax its citizens who are residents of Thailand as if the treaty were not in force. "Residents" for purposes of the proposed treaty (and, thus, for purposes of the saving clause) includes persons defined as such in Article 4 (Residence), including corporations and other entities as well as individuals.

The proposed treaty contains a provision under which the saving clause (and therefore the U.S. jurisdiction to tax) applies to a former U.S. citizen or a former long-term resident (whether or not

[6] See Rev. Rul. 84–17, 1984–1 C.B. 308.

treated as such under Article 4 (Residence)), whose loss of citizenship or resident status, respectively, had as one of its principal purposes the avoidance of tax; such application is limited to the ten-year period following the loss of citizenship or resident status. Section 877 of the Code provides special rules for the imposition of U.S. income tax on former U.S. citizens and long-term residents for a period of ten years following the loss of citizenship or resident status; these special tax rules apply to a former citizen or long-term resident only if his or her loss of U.S. citizenship or resident status had as one of its principal purposes the avoidance of U.S. income, estate or gift taxes. For purposes of applying the special tax rules to former citizens and long-term residents, individuals who meet a specified income tax liability threshold or a specified net worth threshold generally are considered to have lost citizenship or resident status for a principal purpose of U.S. tax avoidance.

Exceptions to the saving clause are provided for the following benefits conferred by a treaty country: the allowance of correlative adjustments when the profits of an associated enterprise are adjusted by the other country (Article 9, paragraph 2); the exemption from residence country tax for recipients of social security benefits and child support payments (Article 20, paragraphs 2 and 5); relief from double taxation through the provision of a foreign tax credit (Article 25); protection from discriminatory tax treatment (Article 26); and benefits under the mutual agreement procedures (Article 27). These exceptions to the saving clause permit residents and citizens of the United States or Thailand to obtain such benefits of the proposed treaty with respect to their country of residence or citizenship.

In addition, the saving clause does not apply to the following benefits conferred by one of the countries upon individuals who neither are citizens of that country nor have immigrant status in that country. Under this set of exceptions to the saving clause, the specified treaty benefits are available to, for example, a Thai citizen who spends enough time in the United States to be taxed as a U.S. resident but who has not acquired U.S. immigrant status (i.e., does not hold a "green card"). The benefits that are covered under this set of exceptions are the exemptions from host country tax for certain government service salaries and pensions (Article 21), certain income received by visiting students and trainees (Article 22), certain income of visiting teachers and researchers (Article 23), and certain income of diplomats and consular officers (Article 29).

The proposed treaty provides that the dispute resolution procedures under its mutual agreement article take precedence over the corresponding provisions of any other agreement to which the United States and Thailand are parties in determining whether a measure is within the scope of the proposed treaty. Unless the competent authorities agree that a taxation measure is outside the scope of the proposed treaty, only the proposed treaty's nondiscrimination rules, and not the nondiscrimination rules of any other agreement in effect between the United States and Thailand, generally apply to that law or other measure. The only exception to this general rule is such national treatment or most favored nation obligations as may apply to trade in goods under the General

Agreement on Tariffs and Trade. For purposes of this provision, the term "measure" means a law, regulation, rule, procedure, decision, administrative action, or any other form of measure.

Article 2. Taxes Covered

The proposed treaty generally applies to the income taxes of the United States and Thailand. However, Article 28 (Exchange of Information) generally is applicable to all taxes imposed by the United States under the Code (including gift, estate and excise taxes), and by Thailand under the Thai Revenue Code and the Petroleum Income Tax Act.

In the case of the United States, the proposed treaty applies to the Federal income taxes imposed by the Code, but excludes social security taxes. Unlike many U.S. income tax treaties in force, but like the U.S. model, the proposed treaty applies to the accumulated earnings tax and the personal holding company tax. The proposed treaty does not apply to any U.S. State or local income taxes.

In the case of Thailand, the proposed treaty applies to the income tax and the petroleum income tax.

The proposed treaty also contains a rule generally found in U.S. income tax treaties and the U.S., OECD and U.N. models which provides that the proposed treaty applies to any identical or substantially similar taxes that may be imposed subsequently in addition to or in place of the taxes covered. The proposed treaty obligates the competent authority of each country to notify the competent authority of the other country of any significant changes in its internal tax laws, and of any official published material concerning the application of the proposed treaty, including explanations, regulations, rulings or judicial decisions. The Technical Explanation states that the term "significant" means that changes must be reported that are significant to the operation of the proposed treaty.

Article 3. General Definitions

The proposed treaty provides definitions of a number of terms for purposes of the proposed treaty. Certain of the standard definitions found in most U.S. income tax treaties are included in the proposed treaty.

The term "Thailand" means the territory of the Kingdom of Thailand. The Technical Explanation states that the term "Thailand" is understood to include the territorial waters of Thailand. The proposed treaty further provides that the term includes any area adjacent to the territorial waters of Thailand over which Thailand exercises rights, in accordance with Thai and international laws, with respect to the seabed and subsoil and their natural resources. The Technical Explanation states that the extension of the definition to such adjacent areas of the territorial sea of Thailand applies only if the person, property or activity to which the proposed treaty is being applied is connected with the exploration or exploitation of natural resources.

The term "United States" means the United States of America, but does not include Puerto Rico, the Virgin Islands, Guam, or any other U.S. possession or territory. The Technical Explanation states that the term "United States" is understood to include the

States, the District of Columbia and the territorial sea of the United States. When used in the geographic sense, the term "United States" includes any area outside the territorial sea of the United States over which the United States exercises rights, in accordance with U.S. and international laws, with respect to the exploration and exploitation of the natural resources of the seabed or its subsoil. The Technical Explanation states that the extension of the term to such areas outside the territorial sea of the United States applies only if the person, property or activity to which the proposed treaty is being applied is connected with such natural resource exploration or exploitation.

The term "person" includes an individual, an estate, a trust, a partnership, a company, and any other body of persons.

A "company" under the proposed treaty is any body corporate or any entity which is treated as a body corporate for tax purposes. The Technical Explanation states that, for U.S. tax purposes, the principles of Treas. Reg. section 301.7701-2 generally are applicable in determining whether an entity is taxed as a body corporate.

The terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean, respectively, an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State. The proposed treaty does not define the term "enterprise." The Technical Explanation states that the term "enterprise" generally is understood to refer to any activity or set of activities that constitutes a trade or business. The terms "a Contracting State" and "the other Contracting State" mean the United States or Thailand, according to the context in which such terms are used.

The term "tax" means United States tax, or Thai tax, as the case may be. United States tax and Thai tax are defined in Article 2 (Taxes Covered) of the proposed treaty.

The U.S. "competent authority" is the Secretary of the Treasury or his delegate. The U.S. competent authority function has been delegated to the Commissioner of Internal Revenue, who has redelegated the authority to the Assistant Commissioner (International). On interpretative issues, the latter acts with the concurrence of the Associate Chief Counsel (International) of the IRS. The Thai "competent authority" is the Minister of Finance or his authorized representative.

The proposed treaty provides that the term "nationals" means all individuals possessing the nationality or citizenship of the United States or Thailand, and all legal persons, partnerships, associations and any other entities deriving their status as such from the laws in force in the United States or Thailand.

The proposed treaty also contains the standard provision that, unless the context otherwise requires or the competent authorities agree to a common meaning, all terms not defined in the proposed treaty have the meaning that they have under the laws of the country concerning the taxes to which the proposed treaty applies. The Technical Explanation states that where a term is defined both under a country's tax law and under a non-tax law, the definition in the tax law is to be used in applying the proposed treaty.

Article 4. Residence

The assignment of a country of residence is important because the benefits of the proposed treaty generally are available only to a resident of one of the treaty countries as that term is defined in the proposed treaty. Furthermore, issues arising because of dual residency, including situations of double taxation, may be avoided by the assignment of one treaty country as the country of residence when under the internal laws of the treaty countries a person is a resident of both countries.

Internal taxation rules

United States

Under U.S. law, the residence of an individual is important because a resident alien, like a U.S. citizen, is taxed on his or her worldwide income, while a nonresident alien is taxed only on certain U.S.-source income and on income that is effectively connected with a U.S. trade or business. An individual who spends sufficient time in the United States in any year or over a three-year period generally is treated as a U.S. resident. A permanent resident for immigration purposes (i.e., a "green card" holder) also is treated as a U.S. resident.

Under U.S. law, a company is taxed on its worldwide income if it is a "domestic corporation." A domestic corporation is one that is created or organized in the United States or under the laws of the United States, a State, or the District of Columbia.

Thailand

Under Thai law, resident individuals generally are subject to tax on their worldwide income, while nonresident individuals are subject to tax only on certain income derived from sources within Thailand. A nonresident individual includes a person who resides in Thailand for less than 180 days.

Under Thai law, a corporation generally is subject to tax on worldwide income if it is incorporated in Thailand. Corporations that are incorporated under foreign law generally are subject to tax only on certain income derived from sources within Thailand.

Proposed treaty rules

The proposed treaty specifies rules to determine whether a person is a resident of the United States or Thailand for purposes of the proposed treaty. The rules generally are consistent with the rules of the U.S. model.

The proposed treaty generally defines "resident of a Contracting State" to mean any person who, under the laws of that country, is liable to tax in that country by reason of the person's domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature. According to the Technical Explanation, the reference in the proposed treaty to persons "liable to tax" in a country is interpreted as referring to those persons subject to the taxation laws of such country; the reference therefore includes tax-exempt organizations that are subject to the tax laws of a country (even though such organizations are exempt from tax).

The term “resident of a Contracting State” also includes the United States or Thailand and any of its political subdivisions or local authorities. The term “resident of a Contracting State” does not include any person that is liable to tax in that country only on income from sources in that country. Under the proposed treaty, a U.S. citizen or an alien admitted to the United States for permanent residence (a “green card” holder), who is not a resident of Thailand under the basic residence rules, will be treated as a U.S. resident only if such individual has a substantial presence, permanent home or habitual abode in the United States. If such individual is a resident of Thailand under the basic residence rules, he or she is considered to be a resident of both countries and his or her residence for purposes of the proposed treaty is determined under the tie-breaker rules described below.

Although not specifically provided for in the proposed treaty, the Technical Explanation addresses residence issues for purposes of the proposed treaty in the case of fiscally transparent entities (e.g., partnerships, estates and trusts) that are not subject to an entity-level tax. The Technical Explanation states that in the case of the United States, such entities include partnerships, common investment trusts under section 584 of the Code, grantor trusts and U.S. limited liability companies treated as partnerships for U.S. tax purposes. The Technical Explanation states that it is the Treasury Department’s understanding that an item of income derived through such fiscally transparent entities will be considered to be derived by a resident of a country if the resident is treated under the tax laws of the country where such person is resident as deriving the item of income. Thus, for example, if the U.S. partners’ share in the income of a U.S. limited liability company (treated as a partnership for U.S. tax purposes) is only one-half, Thailand would be required to reduce its withholding tax pursuant to the proposed treaty on only one-half of the Thai-source income paid to the partnership.

The Technical Explanation states that these rules for income derived through fiscally transparent entities apply regardless of where the entity is organized (i.e., in the United States, Thailand or a third country). The Technical Explanation also states that these rules apply even if the entity is viewed differently under the tax laws of the other country. As an example, the Technical Explanation states that income from Thai sources received by an entity organized under the laws of Thailand, which is treated for U.S. tax purposes as a corporation and is owned by a U.S. shareholder who is a U.S. resident for U.S. tax purposes, is not considered derived by the shareholder of that corporation, even if under the tax laws of Thailand the entity is treated as fiscally transparent. Rather, for purposes of the proposed treaty, the income is treated as derived by the Thai entity.

Dual residents

Individuals

A set of “tie-breaker” rules is provided to determine residence in the case of an individual who, under the basic residence rules, would be considered to be a resident of both countries. Under these

rules, an individual is deemed to be a resident of the country in which he or she has a permanent home available. If the individual has a permanent home in both countries, the individual's residence is deemed to be the country with which his or her personal and economic relations are closer (i.e., his or her "center of vital interests"). If the country in which the individual has his or her center of vital interests cannot be determined, or if he or she does not have a permanent home available in either country, he or she is deemed to be a resident of the country in which he or she has an habitual abode. If the individual has an habitual abode in both countries or in neither country, he or she is deemed to be a resident of the country of which he or she is a national. If the individual is a national of both countries or neither country, the competent authorities of the countries will settle the question of residence by mutual agreement.

Entities

In the case of any person other than an individual that is a resident of both countries under the basis residence rules, the proposed treaty requires the competent authorities to settle the issue of residence by mutual agreement and to determine the mode of application of the proposed treaty to such person. Under the U.S. model, if a company is a resident of both countries, it is deemed to be a resident of the country in which it is created or organized. The Technical Explanation states that this rule is not contained in the proposed treaty because dual corporate residence cannot occur under the laws of the United States and Thailand.

Article 5. Permanent Establishment

The proposed treaty contains a definition of the term "permanent establishment" that generally follows the pattern of other recent U.S. income tax treaties, the U.S. model, the OECD model and the U.N. model.

The permanent establishment concept is one of the basic devices used in income tax treaties to limit the taxing jurisdiction of the host country and thus to mitigate double taxation. Generally, an enterprise that is a resident of one country is not taxable by the other country on its business profits unless those profits are attributable to a permanent establishment of the resident in the other country. In addition, the permanent establishment concept is used to determine whether the reduced rates of, or exemptions from, tax provided for dividends, interest, and royalties apply, or whether those items of income will be taxed as business profits.

In general, under the proposed treaty, a permanent establishment is a fixed place of business through which the business of an enterprise is wholly or partly carried on. A permanent establishment includes a place of management, a branch, an office, a factory, a workshop, a warehouse (in relation to a person performing storage facilities for others), and a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources. It also includes a building site, a construction, assembly, or installation project, or supervisory activities in connection therewith, or an installation or drilling rig or ship used for the exploration or exploitation of natural resources, but only if such site, project, or activi-

ties continue for more than 120 days within any 12-month period. The Technical Explanation states that the 120-day test applies separately to each individual site or project, with a series of contracts or projects that are interdependent both commercially and geographically treated as a single project. The Technical Explanation further states that if the 120-day threshold is exceeded, the site or project constitutes a permanent establishment as of the first day that work in the country began within the 12-month period. This rule providing the 120-day period for establishing a permanent establishment in connection with a site, project, rig, or ship is significantly shorter than the twelve-month period provided in the corresponding rule of the U.S. model, and the six-month periods contained in the U.N. model and U.S. treaties with some other countries.

The proposed treaty further provides that a permanent establishment includes the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose if the activities of that nature continue (for the same or a connected project) within that country for a period or periods aggregating more than 90 days within any 12-month period, provided that a permanent establishment does not exist in any taxable year in which such services are rendered in that country for a period or periods aggregating less than 30 days in that taxable year. In addition, the furnishing of services by an enterprise through its employees also will be deemed to constitute a permanent establishment if the services are performed within a country for a related enterprise within the meaning of Article 9 (Associated Enterprises). These rules regarding the performance of services as constituting a permanent establishment are not contained in the U.S. or OECD models. A similar, but not identical rule is contained in the U.N. model, which provides that the furnishing of services in a country by an enterprise through its employees can give rise to a permanent establishment if the activity continues in the country for a period or periods of more than six months in any 12-month period. The proposed treaty's 90-day rule grants the source country broader rights to tax residents of the other country than the six-month rule in the U.N. model.

Under the proposed treaty, the following activities are deemed not to constitute a permanent establishment: the use of facilities solely for storing or displaying goods or merchandise belonging to the enterprise; the maintenance of a stock of goods or merchandise belonging to the enterprise solely for storage or display, or solely for processing by another enterprise; the maintenance of a fixed place of business solely for the purchase of goods or merchandise or for the collection of information for the enterprise; and the maintenance of a fixed place of business solely for the purpose of carrying on for the enterprise any other activity of a preparatory or auxiliary character. The Technical Explanation gives advertising and supplying information as examples of preparatory and auxiliary activities that would not give rise to a permanent establishment. In addition, the proposed treaty provides that a permanent establishment does not include the maintenance of a fixed place of business solely for the purpose of any combination of the activities described above, provided that the overall activity of the fixed place of busi-

ness resulting from this combination is of a preparatory or auxiliary character. This latter rule, which is similar to the rule in the OECD model, differs from the rule in the U.S. model. The U.S. model provides that the maintenance of a fixed place of business solely for any combination of the above-listed activities does not constitute a permanent establishment, without requiring that the overall combination of activities be of a preparatory or auxiliary character.

The proposed treaty provides that a permanent establishment also is deemed not to include the use of facilities or the maintenance of a stock of goods or merchandise belonging to the enterprise for the purpose of occasional delivery of such goods or merchandise. This rule is different from the rules in the U.S. and OECD models, which provide that a permanent establishment does not include the use of facilities or the maintenance of a stock of goods or merchandise belonging to the enterprise solely for delivery. The Technical Explanation states that under the proposed treaty, a permanent establishment will be deemed to exist if deliveries are made on a regular basis from a warehouse or other storage facility.

Under the proposed treaty, an enterprise is deemed to have a permanent establishment if it engages in business in a country through an agent who has, and regularly exercises, the authority to conclude contracts in the name of such enterprise, unless the contracting authority is limited to the activities listed above, such as storage or display of merchandise, which if exercised through a fixed place of business would be excluded from the definition of a permanent establishment. A permanent establishment of an enterprise also is deemed to exist if the agent regularly secures orders in that country for that enterprise. This rule is not contained in the U.S. or OECD models. A permanent establishment of an enterprise also is deemed to exist if the agent maintains in that country a stock of goods or merchandise belonging to the enterprise from which the agent regularly makes deliveries on behalf of the enterprise. This rule, which is not contained in the U.S. or OECD models, is similar to a rule contained in the U.N. model.

Under the proposed treaty, no permanent establishment is deemed to arise merely because the enterprise carries on business in a country through a broker, general commission agent, or any other agent of independent status, provided that such persons are acting in the ordinary course of their business. Unlike the U.S. model, but similar to the U.N. model, the proposed treaty provides that when by agreement between the agent and the enterprise, the activities of such agent are devoted wholly on behalf of that enterprise and other enterprises controlling, or controlled by, that enterprise, such agent will not be considered to be an independent agent for purposes of the foregoing rule.

The fact that a company that is a resident of one country controls or is controlled by a company that is a resident of the other country or that carries on business in the other country (whether through a permanent establishment or otherwise) does not of itself cause either company to be a permanent establishment of the other.

Article 6. Income from Immovable (Real) Property

This article covers income from real property. The rules in Article 13 (Gains) cover gains from the sale of real property.

Under the proposed treaty, income derived by a resident of one country from immovable (real) property (including income from agriculture or forestry) situated in the other country may be taxed in the country where the property is located. This rule is consistent with the rules in the U.S., OECD and U.N. models.

The terms "immovable property" or "real property" have the meanings which they have under the law of the country in which the property in question is situated.[7] The proposed treaty specifies that the term in any case includes property accessory to immovable property; livestock and equipment used in agriculture and forestry; rights to which the provisions of general law respecting landed property apply; usufruct of immovable property; and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources, and other natural resources. Ships, boats, and aircraft are not considered to be immovable property.

The proposed treaty specifies that the country in which the property is situated may tax income derived from the direct use, letting, or use in any other form of immovable property. The proposed treaty further provides that the rules of this article permitting source-country taxation apply to the income from immovable property of an enterprise and to income from immovable property used for the performance of independent personal services.

Article 7. Business Profits

Internal taxation rules

United States

U.S. law distinguishes between the U.S. business income and the other U.S. income of a nonresident alien or foreign corporation. A nonresident alien or foreign corporation is subject to a flat 30-percent rate (or lower treaty rate) of tax on certain U.S.-source income if that income is not effectively connected with the conduct of a trade or business within the United States. The regular individual or corporate rates apply to income (from any source) which is effectively connected with the conduct of a trade or business within the United States.

The treatment of income as effectively connected with a U.S. trade or business depends upon whether the source of the income is U.S. or foreign. In general, U.S.-source periodic income (such as interest, dividends, rents, and wages) and U.S.-source capital gains are effectively connected with the conduct of a trade or business within the United States if the asset generating the income is used in (or held for use in) the conduct of the trade or business or if the activities of the trade or business were a material factor in the realization of the income. All other U.S.-source income of a person engaged in a trade or business in the United States is treated as effectively connected with the conduct of a trade or business in the

[7] In the case of the United States, the term "real property" is defined in Treas. Reg. sec. 1.897–1(b).

United States (under what is referred to as the “force of attraction” rule).

Foreign-source income generally is effectively connected income only if the foreign person has an office or other fixed place of business in the United States and the income is attributable to that place of business. Only three types of foreign-source income are considered to be effectively connected income: rents and royalties for the use of certain intangible property derived from the active conduct of a U.S. business; certain dividends and interest either derived in the active conduct of a banking, financing or similar business in the United States or received by a corporation the principal business of which is trading in stocks or securities for its own account; and certain sales income attributable to a U.S. sales office. Special rules apply for purposes of determining the foreign-source income that is effectively connected with a U.S. business of an insurance company.

Any income or gain of a foreign person for any taxable year that is attributable to a transaction in another year is treated as effectively connected with the conduct of a U.S. trade or business if it would have been so treated had it been taken into account in that other year (Code sec. 864(c)(6)). In addition, if any property ceases to be used or held for use in connection with the conduct of a trade or business within the United States, the determination of whether any income or gain attributable to a sale or exchange of that property occurring within ten years after the cessation of business is effectively connected with the conduct of a trade or business within the United States is made as if the sale or exchange occurred immediately before the cessation of business (Code sec. 864(c)(7)).

Thailand

Foreign corporations and nonresident individuals generally are subject to Thai tax only on income derived in Thailand. Business income derived in Thailand by a foreign corporation or nonresident individual generally is taxed in the same manner as income of a Thai corporation or resident individual.

Proposed treaty limitations on internal law

Business profits subject to host country tax

Under the proposed treaty, income or profits of an enterprise of one of the countries are taxable in the other country if the enterprise carries on business through a permanent establishment within the other country, but only so much of the income or profits that is attributable to that permanent establishment. In addition, the proposed treaty provides that income or profits of an enterprise of one of the countries may be taxable in the other country even though the permanent establishment was not involved in the generation of such profits if two conditions are met. First, the profits must be derived either from the sale in the other country of goods or merchandise of the same or similar kind as those sold through the permanent establishment, or from other business activities carried on in the other country of the same or similar kind as those effected through the permanent establishment. Second, it must be proved that the sale or activities were structured in a manner in-

tended to avoid taxation in the country in which the permanent establishment is located. Taxation by the source country of this category of profits represents a limited force of attraction rule that is similar to, but narrower than, the rule in some other U.S. treaties. The intent of the provision is to permit the source country to tax the income derived from sales or other business activities within its borders by the home office of the enterprise if such sales or activities are the same as or similar to sales or activities conducted there by the permanent establishment. Such profits may not be taxed by the source country, however, unless it is established that the transactions were structured to avoid tax.

The limited force of attraction rule described in the foregoing paragraph is not contained in the U.S. or OECD models, and is similar to, but narrower than, a corresponding rule contained in the U.N. model. Under the U.N. model, if an enterprise of one country derives income from the sale of goods or the carrying on of other business activities through a permanent establishment situated in either country, income derived directly by the enterprise from the sale of goods of the same or similar kind as those sold through the permanent establishment, or from the carrying on of activities of the same or similar kind as those carried on through the permanent establishment may be attributed to the permanent establishment. Unlike the U.N. model, the rule in the proposed treaty applies only if it can be shown that such sales or activities were not carried out by the permanent establishment in order to avoid tax in the country in which it was located.

The taxation of business profits under the proposed treaty differs from U.S. internal law rules for taxing business profits primarily by requiring more than merely being engaged in a trade or business before a country can tax business profits and by substituting an “attributable to” standard for the Code’s “effectively connected” standard. Under the proposed treaty, some level of fixed place of business would have to be present and the business profits generally would have to be attributable to that fixed place of business (or subject to the limited force of attraction rule described above).

The proposed treaty provides that there will be attributed to a permanent establishment the income or profits which it might be expected to make if it were a distinct and independent entity engaged in the same or similar activities under the same or similar conditions. The Technical Explanation states that amounts may be attributed to the permanent establishment whether or not they are from sources within the country in which the permanent establishment is located.

Like the OECD and U.N. models, but unlike the U.S. model, the proposed treaty provides that a country may, where it is customary to do so under its law and practice, determine the income or profits attributable to a permanent establishment on the basis of an apportionment of the total profits of the enterprise to its various parts, or in the case of a person who does not claim taxation on the basis of the actual net profits of the permanent establishment, on the basis of a certain reasonable percentage of the gross receipts of the permanent establishment. The proposed treaty provides that the method adopted must yield a result that is in accordance with the principles of this article. The Technical Explanation states that

any such method must be designed to approximate an arm's-length result.

Treatment of expenses

In computing taxable business profits, the proposed treaty provides that deductions are allowed for expenses, wherever incurred, which are incurred for the purposes of the permanent establishment. These deductions include a reasonable allocation or apportionment of executive and general administrative expenses incurred for purposes of the permanent establishment. Unlike the U.S. model, the proposed treaty does not specify that research and development expenses and interest also may allocated on a reasonable basis for these purposes. The Technical Explanation states that it is understood that such types of expense allocations are permissible.

The Technical Explanation states that no deductions are allowed for expenses charged to a permanent establishment by another unit of the enterprise. Thus, a permanent establishment may not deduct a royalty deemed paid to its head office. The Technical Explanation states that a permanent establishment may not increase its business profits by the amount of any notional fees for ancillary services performed for another unit of the enterprise, and also may not deduct expenses in providing such services, because those expenses would be incurred for purposes of a business unit other than the permanent establishment.

Other rules

Income or profits are not attributed to a permanent establishment merely by reason of the purchase of goods or merchandise by the permanent establishment for the enterprise. Thus, where a permanent establishment purchases goods for its head office, the business profits attributed to the permanent establishment with respect to its other activities are not increased by a profit element in its purchasing activities.

The income or profits attributable to a permanent establishment must be determined under the same method each year unless there is a good and sufficient reason to the contrary. Where income or profits include items of income that are dealt with separately in other articles of the proposed treaty, those other articles, and not the business profits article, govern the treatment of those items of income (except where such other articles specifically provide to the contrary). Thus, for example, dividends are taxed under the provisions of Article 10 (Dividends), and not as business profits, except as specifically provided in Article 10.

The proposed treaty provides that the term "business profits" means income derived from any trade or business. The Technical Explanation states that the term "business profits" is understood to include income from the performance of personal services by an enterprise. Unlike the U.S. model, the proposed treaty provides that the term "business profits" includes profits from the rental of ships, aircraft and containers (including trailers, barges and related equipment for the transport of containers), if such profits are not incidental to income from the operation of ships or aircraft in international traffic. The Technical Explanation states that the in-

clusion of such profits from the rental of ships, aircraft and containers in the definition of "business profits" makes clear that such income earned by a resident of a country can be taxed by the other country only if such income is attributable to a permanent establishment in the other country.

The proposed treaty incorporates the rule of Code section 864(c)(6) and provides that any income attributable to a permanent establishment or a fixed base during its existence is taxable in the country where the permanent establishment or fixed base is located even though payments are deferred until after the permanent establishment or fixed base has ceased to exist. This rule applies with respect to business profits (Article 7, paragraphs 1 and 2), dividends (Article 10, paragraph 5), interest (Article 11, paragraph 5), royalties (Article 12, paragraph 4), independent personal services income (Article 15, paragraph 1(a)), and other income (Article 24, paragraph 2).

Article 8. Shipping and Air Transport

Article 8 of the proposed treaty covers income from the operation or rental of ships, aircraft, and containers in international traffic. The rules governing income from the disposition of ships, aircraft, and containers are contained in Article 13 (Gains).

The United States generally taxes the U.S.-source income of a foreign person from the operation of ships or aircraft to or from the United States. An exemption from U.S. tax is provided if the income is earned by a corporation that is organized in, or an alien individual who is resident in, a foreign country that grants an equivalent exemption to U.S. corporations and residents. The United States has entered into agreements with a number of countries providing such reciprocal exemptions.

The proposed treaty provides that income or profits derived by a U.S. resident from the operation of aircraft in international traffic is taxable only in the United States. Similarly, the proposed treaty provides that income or profits derived by a Thai resident from the operation of aircraft in international traffic is taxable only in Thailand. The Technical Explanation states that such income derived by a resident of one of the countries may not be taxed in the other country even if the resident has a permanent establishment in that other country.

Unlike the U.S. model and most U.S. tax treaties, this rule granting the country of residence the exclusive right to tax income applies only with respect to income from the operation of aircraft in international traffic, and not to income from the operation of ships. Rather, the proposed treaty provides limited source-country taxation of income from the operation of ships in international traffic. In this regard, the proposed treaty provides that the amount of Thai tax that may be imposed on income or profits derived by a resident of the United States from the operation of ships in international traffic is reduced to 50 percent of the amount which would have been imposed in the absence of the proposed treaty. Similarly, the proposed treaty provides that the amount of U.S. tax that may be imposed on income or profits derived by a resident of Thailand from the operation of ships in international traffic is reduced to 50 percent of the amount which would have been imposed in the ab-

sence of the proposed treaty. As an example, the Technical Explanation states that the income of a Thai shipping company from the operation of ships in international traffic would be limited to 2 percent of the company's U.S.-source gross transportation income from such operation (under section 887 of the Code, the U.S. tax rate is 4 percent). The diplomatic notes provide that if Thailand agrees in a treaty or other agreement with any other country to a tax rate on income or profits derived by residents of the other country on the operation of ships that is lower than the rate provided for in the proposed treaty for shipping profits (i.e., 50 percent of Thailand's tax rate), then Thailand will agree to reopen negotiations with the United States with a view to concluding a protocol which would extend such lower rate to U.S. residents.

"International traffic" means any transport by a ship or aircraft, except where the transport is solely between places in the other country (Article 3(1)(d) (General Definitions)). Accordingly, with respect to a Thai enterprise, purely domestic transport within the United States does not constitute "international traffic."

For purposes of the proposed treaty, income or profits derived from the operation of ships or aircraft in international traffic include income or profits derived from the rental of ships or aircraft, if such rental profits are incidental to other income or profits from the operation of ships or aircraft in international traffic. The Technical Explanation states that the rental of ships or aircraft is incidental to income from the operation of ships or aircraft in international traffic if the lessor is a shipping company or airline, and the ship or aircraft is part of the body of equipment used by the lessor in its business as an international carrier. Thus, under the proposed treaty, the exemption from source-country tax for shipping profits would not apply to a bareboat lessor (such as a financial institution or leasing company) that does not operate ships or aircraft in international traffic, but that leases ships or aircraft for use in international traffic. This treatment is different from the U.S. model, which would permit the exemption from source-country tax if the ship or aircraft was operated in international traffic by the lessee. The Technical Explanation states that income from the leasing of ships and aircraft on a full basis when such ships are used in international traffic is considered to be income from the operation of ships and aircraft in international traffic (and, thus, is covered under the general rules described in the foregoing paragraphs).

The proposed treaty provides that income or profits of an enterprise of a country from the use, maintenance, or rental of containers (including trailers, barges, and related equipment for the transport of containers) that are incidental to income from the operation of ships or aircraft in international traffic is treated as income from the operation of ships or aircraft in international traffic for purposes of the rules described in the foregoing paragraphs. This rule is different from the U.S. model, which provides that such profits are treated as income from the operation of ships or aircraft in international traffic if such transport is undertaken as part of international traffic, without requiring that such income be incidental to the enterprise's income from the operation of ships or aircraft in international traffic. The diplomatic notes provide that if

Thailand agrees in a treaty or other agreement with any other country to treatment for the rental or use of containers in international traffic that is more favorable than the treatment for such income under the proposed treaty (i.e., under this article or under the business profits article (Article 7)), then Thailand will agree to reopen negotiations with the United States with a view to concluding a protocol which would extend such more favorable treatment to U.S. residents.

The shipping and air transport provisions of the proposed treaty apply to profits from participation in a pool, joint business, or international operating agency. This refers to various arrangements for international cooperation by carriers in shipping and air transport.

The proposed treaty does not specify, as does the corresponding article in the U.S. model, that income earned by an enterprise from the inland transport of property or passengers within either country falls within the rules of this article if the transport is undertaken as part of the international transport of property or passengers by that enterprise. The Technical Explanation states that the proposed treaty should be interpreted consistently with this rule.

Article 9. Associated Enterprises

The proposed treaty, like most other U.S. tax treaties, contains an arm's-length pricing provision. The proposed treaty recognizes the right of each country to make an allocation of profits to an enterprise of that country in the case of transactions between related enterprises, if conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises. In such a case, a country may allocate to such an enterprise the profits which it would have accrued but for the conditions so imposed. This treatment is consistent with the U.S. model.

For purposes of the proposed treaty, an enterprise of one country is related to an enterprise of the other country if one of the enterprises participates directly or indirectly in the management, control, or capital of the other enterprise. Enterprises are also related if the same persons participate directly or indirectly in their management, control, or capital.

Under the proposed treaty, when a redetermination of tax liability has been made by one country under the provisions of this article, the other country will make an appropriate adjustment to the amount of tax paid in that country on the redetermined income if it agrees that the adjustment was correct. In making such adjustment, due regard is to be given to other provisions of the proposed treaty, and the competent authorities of the two countries are to consult with each other if necessary. The proposed treaty's saving clause retaining full taxing jurisdiction in the country of residence or citizenship does not apply in the case of such adjustments. Accordingly, internal statute of limitations provisions do not prevent the allowance of appropriate correlative adjustments.

According to the Technical Explanation, it is understood that this article does not replace the internal law provisions that permit this type of adjustment. Adjustments are permitted under internal law provisions even if such adjustments are different from, or go be-

yond, the adjustments authorized by this article, provided that such adjustments are consistent with the general principles of this article permitting adjustments to reflect arm's-length terms. The Technical Explanation states that this article also permits the tax authorities of the countries to address thin capitalization issues.

Article 10. Dividends

Internal taxation rules

United States

The United States generally imposes a 30-percent tax on the gross amount of U.S.-source dividends paid to nonresident alien individuals and foreign corporations. The 30-percent tax does not apply if the foreign recipient is engaged in a trade or business in the United States and the dividends are effectively connected with that trade or business. In such a case, the foreign recipient is subject to U.S. tax on such dividends on a net basis at graduated rates in the same manner that a U.S. person would be taxed.

Under U.S. law, the term dividend generally means any distribution of property made by a corporation to its shareholders, either from accumulated earnings and profits or current earnings and profits. However, liquidating distributions generally are treated as payments in exchange for stock and thus are not subject to the 30-percent withholding tax described above (see discussion of capital gains in connection with Article 13 below).

Dividends paid by a U.S. corporation generally are U.S.-source income. Also treated as U.S.-source dividends for this purpose are portions of certain dividends paid by a foreign corporation that conducts a U.S. trade or business. The U.S. 30-percent withholding tax imposed on the U.S.-source portion of the dividends paid by a foreign corporation is referred to as the "second-level" withholding tax. This second-level withholding tax is imposed only if a treaty prevents application of the statutory branch profits tax.

In general, corporations are not entitled under U.S. law to a deduction for dividends paid. Thus, the withholding tax on dividends theoretically represents imposition of a second level of tax on corporate taxable income. Treaty reductions of this tax reflect the view that where the United States already imposes corporate-level tax on the earnings of a U.S. corporation, a 30-percent withholding rate may represent an excessive level of source-country taxation. Moreover, the reduced rate of tax often applied by treaty to dividends paid to direct investors reflects the view that the source-country tax on payments of profits to a substantial foreign corporate shareholder may properly be reduced further to avoid double corporate-level taxation and to facilitate international investment.

A REIT is a corporation, trust, or association that is subject to the regular corporate income tax, but that receives a deduction for dividends paid to its shareholders if certain conditions are met. In order to qualify for the deduction for dividends paid, a REIT must distribute most of its income. Thus, a REIT is treated, in essence, as a conduit for federal income tax purposes. Because a REIT is taxable as a U.S. corporation, a distribution of its earnings is treated as a dividend rather than income of the same type as the under-

lying earnings. Such distributions are subject to the U.S. 30-percent withholding tax when paid to foreign owners.

A REIT is organized to allow persons to diversify ownership in primarily passive real estate investments. As such, the principal income of a REIT often is rentals from real estate holdings. Like dividends, U.S.-source rental income of foreign persons generally is subject to the 30-percent withholding tax (unless the recipient makes an election to have such rental income taxed in the United States on a net basis at the regular graduated rates). Unlike the withholding tax on dividends, however, the withholding tax on rental income generally is not reduced in U.S. income tax treaties.

U.S. internal law also generally treats a regulated investment company ("RIC") as both a corporation and a conduit for income tax purposes. The purpose of a RIC is to allow investors to hold a diversified portfolio of securities. Thus, the holder of stock in a RIC may be characterized as a portfolio investor in the stock held by the RIC, regardless of the proportion of the RIC's stock owned by the dividend recipient.

Thailand

Thailand generally imposes a withholding tax on dividends at a rate of 10 percent.

Proposed treaty limitations on internal law

Under the proposed treaty, dividends paid by a resident of a treaty country to a resident of the other country may be taxed in such other country. Dividends paid by a resident of a treaty country to a resident of the other country may also be taxed by the country in which the payor is resident, but the rate of such tax is limited. Under the proposed treaty, source-country taxation (i.e., taxation by the country in which the payor is resident) generally is limited to 10 percent of the gross amount of the dividend if the beneficial owner of the dividend is a company which owns at least 10 percent of the voting power of the payor company. The source-country dividend withholding tax generally is limited to 15 percent of the gross amount of the dividends paid to residents of the other country in all other cases.

The Technical Explanation states that the term "beneficial owner" is not defined in the proposed treaty and, thus, is defined under the internal law of the source country. The Technical Explanation further states that the beneficial owner of a dividend for purposes of this article is the person to which the dividend income is attributable for tax purposes under the laws of the source country.

The rates of source-country dividend withholding tax permitted under the proposed treaty are higher than those provided for in the U.S. model, the OECD model and most other U.S. income tax treaties. The proposed treaty provides that these rules do not affect the taxation of the paying company on the profits out of which the dividends are paid.

The proposed treaty provides that the 15-percent maximum tax rate applies to dividends paid by a RIC. The proposed treaty provides that the 15-percent maximum tax rate applies to dividends paid by a REIT to an individual owning less than 25 percent of the

REIT. There is no limitation in the proposed treaty on the tax that may be imposed by the United States on a REIT dividend that is beneficially owned by a Thai resident, if the beneficial owner of the dividend is either an individual holding a 25 percent or greater interest in the REIT or is not an individual. Thus, such a dividend is taxable at the 30-percent United States statutory rate. The proposed treaty provides that these rules also apply to dividends paid by Thai companies that are similar to a U.S. RIC or REIT. The proposed treaty provides that whether a Thai company is similar to a U.S. RIC or REIT will be determined by mutual agreement of the competent authorities.

The proposed treaty generally defines "dividends" as income from shares or other rights, which are not debt claims and which participate in profits. The term also includes income from other corporate rights if such income is subjected to the same tax treatment as income from shares by the country in which the distributing corporation is resident. The proposed treaty also provides that the term "dividends" includes income from arrangements, including debt obligations, that carry the right to participate in profits, to the extent such income is so characterized under the laws of the country in which the income arises.

The proposed treaty's reduced rates of tax on dividends do not apply if the dividend recipient carries on business through a permanent establishment in the source country, or performs in the source country independent personal services from a fixed base located in that country, and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment or fixed base. In such cases, the dividends effectively connected to the permanent establishment or the fixed base are taxed as business profits (Article 7) or as income from the performance of independent personal services (Article 15), as the case may be. Under the proposed treaty, these rules also apply if the permanent establishment or fixed base no longer exists when the dividends are paid but such dividends are attributable to the former permanent establishment or fixed base.

Article 11. Interest

Internal taxation rules

United States

Subject to several exceptions (such as those for portfolio interest, bank deposit interest, and short-term original issue discount), the United States imposes a 30-percent withholding tax on U.S.-source interest paid to foreign persons under the same rules that apply to dividends. U.S.-source interest, for purposes of the 30-percent tax, generally is interest on the debt obligations of a U.S. person, other than a U.S. person that meets specified foreign business requirements. Also subject to the 30-percent tax is interest paid by the U.S. trade or business of a foreign corporation.

Portfolio interest generally is defined as any U.S.-source interest that is not effectively connected with the conduct of a trade or business if such interest (1) is paid on an obligation that satisfies certain registration requirements or specified exceptions thereto and (2) is not received by a 10-percent owner of the issuer of the obliga-

tion, taking into account shares owned by attribution. However, the portfolio interest exemption does not apply to certain contingent interest income.

If an investor holds an interest in a fixed pool of real estate mortgages that is a real estate mortgage interest conduit ("REMIC"), the REMIC generally is treated for U.S. tax purposes as a pass-through entity and the investor is subject to U.S. tax on a portion of the REMIC's income (which, generally is interest income). If the investor holds a so-called "residual interest" in the REMIC, the Code provides that a portion of the net income of the REMIC that is taxed in the hands of the investor—referred to as the investor's "excess inclusion"—may not be offset by any net operating losses of the investor, must be treated as unrelated business income if the investor is an organization subject to the unrelated business income tax, and is not eligible for any reduction in the 30-percent rate of withholding tax (by treaty or otherwise) that would apply if the investor were otherwise eligible for such a rate reduction.

Thailand

Thailand generally imposes a withholding tax on Thai-source interest paid to nonresidents of Thailand at a rate of 15 percent.

Proposed treaty limitations on internal law

The proposed treaty provides that interest arising in one of the countries and paid to a resident of the other country generally may be taxed in both countries. This is contrary to the position of the U.S. model which provides for an exemption from source-country tax for interest earned by a resident of the other country.

The proposed treaty limits the rate of source-country tax that may be imposed on interest income if the beneficial owner of the interest is a resident of the other country. The source-country tax on such interest may not exceed 10 percent of the gross amount of the interest if it is beneficially owned by any financial institution, including an insurance company.

The rate of source-country tax on interest also may not exceed 10 percent of the gross amount of the interest if it is beneficially owned by a resident of the other country and is paid with respect to indebtedness arising as a consequence of a sale on credit by a resident of that other country of any equipment, merchandise, or services. However, this rule does not apply where such sale was between persons not dealing with each other on arm's length terms.

In all other cases, the rate of source-country tax on interest may not exceed 15 percent of the gross amount of such interest. These rates are higher than the rates permitted under the U.S. model and most other U.S. income tax treaties.

The proposed treaty provides for a complete exemption from source-country withholding tax in the case of certain categories of interest earned by residents of the other country. Interest arising in one country and paid to the Government of the other country, or to a resident of that other country with respect to debt obligations guaranteed or insured by that Government, is exempt from source-country tax. The proposed treaty specifies that for purposes of these rules, the term "Government" means in the case of Thai-

land, the Thai Government, the Bank of Thailand, the Export-Import Bank of Thailand, the local authorities, and such financial institutions, the capital of which is wholly owned by the Government of Thailand or any local authority as may be agreed from time to time by the competent authorities. In the case of the United States, the term "Government" means, the U.S. Government, the Federal Reserve Banks, the Export-Import Bank, the Overseas Private Investment Corporation, the States and local authorities, and such financial institutions, the capital of which is wholly owned by the U.S. Government or any State or local authority as may be agreed from time to time by the competent authorities.

The proposed treaty defines the term "interest" as income from debt claims of every kind, whether or not secured by a mortgage and whether or not carrying a right to participate in the debtor's profits. In particular, it includes income from government securities and from bonds or debentures, including premiums or prizes attaching to such securities, bonds, or debentures. The proposed treaty includes in the definition of interest any other income that is treated as income from money lent by the tax law of the country in which the income arises. The proposed treaty provides that the term "interest" does not include amounts treated as dividends under Article 10 (Dividends).

The proposed treaty's reductions in source-country tax on interest do not apply if (1) the beneficial owner of the interest carries on business in the source country through a permanent establishment located in that country, or performs in the source country independent personal services from a fixed base located in that country, and (2) the debt claim in respect of which the interest is paid is effectively connected with such permanent establishment or fixed base, or with certain business activities described in the business profits article (Article 7(1)(b) and (c)) that are similar to those carried by an enterprise through the permanent establishment. In such events, the interest is taxed as business profits (Article 7) or as independent personal services income (Article 15), as the case may be. Under the proposed treaty, the reduction in source-country tax also does not apply if the permanent establishment or fixed base no longer exists when the interest is paid but such interest is attributable to the former permanent establishment or fixed base.

The proposed treaty provides that interest is treated as arising in a country if the payor is that country, including its political subdivisions and local authorities, or a resident of that country.[8] If, however, the payor of the interest has a permanent establishment or a fixed base in a country in connection with which the indebtedness on which the interest is paid was incurred, and the interest is borne by such permanent establishment or fixed base, then the interest would have as its source the country in which the permanent establishment or fixed base is located, regardless of the residence of the payor. Thus, for example, if a French resident has a permanent establishment in Thailand and that French resident incurs indebtedness to a U.S. person, the interest on which is borne

[8] This is consistent with the source rules of U.S. law, which provide as a general rule that interest income has as its source the country in which the payor is resident.

by the Thai permanent establishment, the interest would be treated as having its source in Thailand.

The proposed treaty addresses the issue of non-arm's-length interest charges between related parties (or parties otherwise having a special relationship) by providing that the amount of interest for purposes of applying this article is the amount of interest that would have been agreed upon by the payor and the beneficial owner in the absence of the special relationship. Any amount of interest paid in excess of such amount is taxable according to the laws of each country, taking into account the other provisions of the proposed treaty. For example, excess interest paid by a subsidiary corporation to its parent corporation may be treated as a dividend under local law and thus subject to the provisions of Article 10 (Dividends).

The proposed treaty provides that the reductions in and exemption from source-country tax do not apply to excess inclusions with respect to a residual interest in a U.S. REMIC. Such income may be taxed in accordance with U.S. internal law.

Article 12. Royalties

Internal taxation rules

United States

Under the same system that applies to dividends and interest, the United States imposes a 30-percent withholding tax on U.S.-source royalties paid to foreign persons. U.S.-source royalties include royalties for the use of or the right to use intangible property in the United States.

Thailand

Thailand generally imposes a withholding tax of 15 percent on royalties derived by nonresidents.

Proposed treaty limitations on internal law

The proposed treaty provides that royalties arising in a treaty country paid to a resident of the other country may be taxed by that other country. In addition, the proposed treaty allows the country where the royalties arise (the "source country") to tax such royalties. However, if the beneficial owner of the royalties is a resident of the other country, the source-country tax is limited.

The proposed treaty provides that the rate of source-country tax on certain royalties may not exceed 5 percent of the gross royalties. The 5-percent limitation applies to payments of any kind for the use of, or the right to use, any copyright of literary, artistic, or scientific work, including software, and motion pictures and works on film, tape or other means of reproduction for use in connection with radio or television broadcasting. According to the Technical Explanation, payments with respect to computer software are treated as royalties or as income from the alienation of tangible personal property, depending on the facts and circumstances of the particular transaction. The Technical Explanation also states that it is understood that payments with respect to transfers of "shrink wrap" computer software will be treated as business profits, and not as royalties.

In addition, the rate of source-country tax on certain royalties may not exceed 8 percent of the gross royalties. The 8-percent limitation applies to payments of any kind for the use of, or the right to use, industrial, commercial or scientific equipment. Unlike the proposed treaty, the U.S. model treats such income as business profits, and not as royalties.

The proposed treaty further specifies that the rate of source-country tax on certain royalties may not exceed 15 percent of the gross royalties. The 15-percent limitation applies to payments of any kind for the use of, or the right to use, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience. The Technical Explanation states that the term "industrial, commercial or scientific experience" includes information that is ancillary to a right otherwise giving rise to royalties, such as a patent or secret process.

Under the proposed treaty, the term "royalties" means payments for the use of, or the right to use, property as described in the foregoing paragraphs. In addition, the term "royalties" includes gain derived from the alienation of any right or property that would give rise to such types of royalties, to the extent that the gain is contingent on the productivity, use or disposition thereof.

The proposed treaty's reductions in source-country tax on royalties do not apply if (1) the beneficial owner of the royalties carries on business in the source country through a permanent establishment located in that country, or performs in the source country independent personal services from a fixed base located in that country, and (2) the right or property in respect of which the royalties are paid is effectively connected with such permanent establishment or fixed base, or with certain business activities described in the business profits article (Article 7(1)(c)) that are similar to those carried by an enterprise through the permanent establishment. In such cases, the royalties are taxed as business profits (Article 7) or as independent personal services income (Article 15), as the case may be. Under the proposed treaty, the reduction from source-country tax also does not apply if the permanent establishment or fixed base no longer exists when the royalties are paid but such royalties are attributable to the former permanent establishment or fixed base.

The proposed treaty provides source rules for royalties which differ, in part, from those provided under U.S. internal law. Royalties are deemed to arise within a country if the payor is that country, including its political subdivisions and local authorities, or a resident of that country. If, however, the royalty expense is borne by a permanent establishment or fixed base that the payor has in Thailand or the United States, the royalty has as its source the country in which the permanent establishment or fixed base is located, regardless of the residence of the payor. Thus, for example, if a French resident has a permanent establishment in Thailand and that French resident pays a royalty to a U.S. person which is attributable to the Thai permanent establishment, then the royalty would be treated as having its source in Thailand. In addition, the proposed treaty provides that where the preceding rules do not operate to deem royalties as arising in either the United States or

Thailand, and the royalties relate to the use of, or the right to use, a right or property in one of those countries, the royalties are deemed to arise in that country.

The proposed treaty addresses the issue of non-arm's-length royalties between related parties (or parties otherwise having a special relationship) by providing that the amount of royalties for purposes of applying this article is the amount that would have been agreed upon by the payor and the beneficial owner in the absence of the special relationship, Any amount of royalties paid in excess of such amount is taxable according to the laws of each country, taking into account the other provisions of the proposed treaty. For example, excess royalties paid by a subsidiary corporation to its parent corporation may be treated as a dividend under local law and thus subject to the provisions of Article 10 (Dividends).

Article 13. Gains

Internal taxation rules

United States

Generally, gain realized by a nonresident alien or a foreign corporation from the sale of a capital asset is not subject to U.S. tax unless the gain is effectively connected with the conduct of a U.S. trade or business or, in the case of a nonresident alien, he or she is physically present in the United States for at least 183 days in the taxable year. A nonresident alien or foreign corporation is subject to U.S. tax on gain from the sale of a U.S. real property interest as if the gain were effectively connected with a trade or business conducted in the United States. "U.S. real property interests" include interests in certain corporations if at least 50 percent of the assets of the corporation consist of U.S. real property.

Thailand

Under Thai law, capital gains of foreign corporations from the disposal of shares in a Thai company generally are subject to a 15 percent withholding tax. Other capital gains generally are not subject to tax in Thailand.

Proposed treaty limitations on internal law

The proposed treaty provides that except as otherwise provided in the proposed treaty, each country may tax gains from the alienation of property in accordance with the provisions of its domestic law. This represents a departure from the U.S. model and most other U.S. tax treaties, which generally provide that gain from the alienation of property (other than real property) is subject to tax only in the country in which the seller is resident.

The foregoing rule in the proposed treaty permits the United States to tax gains derived by a resident of the other country that are attributable to the alienation of real property situated in the United States under the rules of section 897 of the Code. Gain from the alienation of real property includes real property referred to in Article 6 (i.e., an interest in the real property itself) and a U.S. real property interest as defined in section 897 of the Code. A U.S. real property interest includes an interest in certain corporations if at

least 50 percent of the assets of the corporation consist of U.S. real property.

The Technical Explanation states that for purposes of this article, the United States will look through distributions made by a REIT. Accordingly, distributions made by a REIT are taxable under this article, and not under the dividends article (Article 10), if the distributions are attributable to gains derived from the alienation of real property.

The Technical Explanation further states that both the residence country and the source country may tax gains from the alienation of movable property that forms a part of the business property of a permanent establishment which an enterprise of one country has in the other country, gains from the alienation of movable property pertaining to a fixed base which is available to a resident of one country in the other country for the purpose of performing independent personal services, and gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or such a fixed base.

The proposed treaty provides that gains from the alienation of ships, aircraft, or containers used or operated by an enterprise of a country in international traffic (or movable property pertaining to the use or operation of such ships, aircraft, or containers) are taxable only in the country of which the enterprise is a resident.

Article 14. Branch Tax

Internal taxation rules

United States

A foreign corporation engaged in the conduct of a trade or business in the United States is subject to a flat 30-percent branch profits tax on its "dividend equivalent amount." The dividend equivalent amount is the corporation's earnings and profits which are attributable to its income that is effectively connected with its U.S. trade or business, decreased by the amount of such earnings that are reinvested in business assets located in the United States (or used to reduce liabilities of the U.S. business), and increased by any such previously reinvested earnings that are withdrawn from investment in the U.S. business. The dividend equivalent amount is limited by (among other things) aggregate earnings and profits accumulated in taxable years beginning after December 31, 1986.

If a U.S. branch of a foreign corporation has allocated to it under Treasury regulation sec. 1.882–5 an interest deduction in excess of the interest actually paid by the branch, such excess interest is treated as if it were paid on a notional loan to a U.S. subsidiary from its foreign corporate parent. This excess interest is subject to 30-percent withholding tax absent a specific statutory exemption.

Thailand

Under Thai law, tax generally is imposed at a 10 percent rate on the profits of a Thai branch of a foreign corporation, after the normal corporate tax, that is remitted to the foreign head office.

Proposed treaty limitations on internal law

The proposed treaty provides that a corporation which is a resident of a country may be subject in the other country to a tax in addition to the tax allowable under other provisions of the proposed treaty.

In the case of the United States, the proposed treaty permits the imposition of a branch profits tax, but limits the rate of such tax to 10 percent. In this regard, the proposed treaty provides that the United States may impose a tax on the "dividend equivalent amount" of the branch profits of a Thai corporation which are effectively connected (or treated as effectively connected) with the conduct of a trade or business in the United States, and which are attributable to a U.S. permanent establishment or that are subject to tax on a net basis as income or gains from real property. The proposed treaty provides that the rate of tax imposed on such dividend equivalent amount may not exceed 10 percent (i.e., the rate specified in Article 10(2)(a)). The Technical Explanation states that the term "dividend equivalent amount" has the same meaning it has under Code section 884(b), as it may be amended, provided that the amendments are consistent with the purposes of the branch profits tax.

In the case of the United States, the proposed treaty permits the imposition of the branch excess interest tax, but limits the rate of source-country tax. In this regard, the proposed treaty provides that the United States may impose a tax on the excess, if any of (1) interest deductible in the United States in computing the profits of a Thai corporation subject to tax in the United States, and that are either attributable to a U.S. permanent establishment or that are subject to tax on a net basis as income or gains from real property, over (2) the interest paid by or from the U.S. permanent establishment or trade or business. The proposed treaty provides that the rate of tax imposed on such excess interest may not exceed the specified rates in the interest article (i.e., 10 or 15 percent, as the case may be, under Article 11(2)). Thus, for example, if the enterprise is a bank, the excess interest tax would be imposed at a 10 percent rate.

In the case of Thailand, the proposed treaty provides that a company which is a resident of the United States and which has a permanent establishment in Thailand remains liable for taxes on disposal of profits out of Thailand in accordance with the provisions of Thai law. The proposed treaty provides that the rate of tax imposed on such profits may not exceed 10 percent.

Article 15. Independent Personal Services

Internal taxation rules

United States

The United States taxes the income of a nonresident alien individual at the regular graduated rates if the income is effectively connected with the conduct of a trade or business in the United States by the individual. The performance of personal services within the United States may constitute a trade or business within the United States.

Under the Code, the income of a nonresident alien individual from the performance of personal services in the United States is excluded from U.S.-source income, and therefore is not taxed by the United States in the absence of a U.S. trade or business, if the following criteria are met: (1) the individual is not in the United States for over 90 days during the taxable year, (2) the compensation does not exceed $3,000, and (3) the services are performed as an employee of, or under a contract with, a foreign person not engaged in a trade or business in the United States, or are performed for a foreign office or place of business of a U.S. person.

Thailand

Nonresident individuals are subject to Thai withholding tax at a rate of 15 percent on certain Thai-source income with respect to the performance of certain professional services.

Proposed treaty limitations on internal law

Under the proposed treaty, income in respect of professional services or other activities of an independent character derived by a resident of a country is taxable in that country. However, such income also may be taxed by the other country (the source country) if the individual performing the services crosses one of three thresholds in the source country, described below. The proposed treaty provides that the term "professional services" includes independent scientific, literary, artistic, educational, or teaching activities, as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

Under the proposed treaty, the individual may be taxed by the source country if he or she has a fixed base regularly available to him or her in the other country for the purpose of performing the activities. In that case, the source country is permitted to tax only that portion of the individual's income which is attributable to that fixed base. Unlike the U.S. model and many U.S. treaties, but like the U.N. model, the proposed treaty does not require that the services be performed in the source country. The Technical Explanation states that the term "fixed base" is understood to be similar, but not identical, to the term "permanent establishment," as defined in the permanent establishment article (Article 5).

In addition, if the individual's stay in the source country is for a period or periods in the aggregate of 90 days or more in the fiscal year concerned, the source country is permitted to tax the income derived from the performances of services in that country during that period. The individual may also be taxed by the source country if the remuneration for the individual's activities in the source country (1) is paid by a resident of the source country or is borne by a permanent establishment or fixed based situated in the source country, and (2) exceeds $10,000 or its equivalent in Thai currency, not including reimbursed expenses.

The foregoing rules are similar, but not identical, to the rules in the U.N. model. Under the U.N. model, the source country is permitted to tax income derived by a resident of a country in respect of professional services if the individual's stay in the source country is for more than 183 days during the year concerned. The proposed treaty's 90-day rule grants the source country broader rights to tax

individual residents of the other country than the 183-day rule in the U.N. model. In addition, the rules represent a departure from the U.S. model, which would permit the source country to tax the income from independent personal services of a resident of the other country only if the income is attributable to a fixed base regularly available to the individual in the source country for the purpose of performing the activities.

The Technical Explanation states that it is understood that the rules of Article 7 (Business Profits) for attributing income and expenses to a permanent establishment are relevant for attributing income to a fixed base; in particular, such income must be taxed on a net basis.

Article 16. Dependent Personal Services

Under the proposed treaty, salaries, wages, and other similar remuneration derived from services performed as an employee in one country (the source country) by a resident of the other country are taxable only by the country of residence if three requirements are met: (1) the individual must be present in the source country for not more than 183 days in any twelve-month period commencing or ending in the taxable year concerned; (2) his or her employer must not be a resident of the source country; and (3) the compensation must not be borne by a permanent establishment or fixed base of the employer in the source country. These limitations on source-country taxation are similar to the rules of the U.S., OECD and U.N. models. The Technical Explanation states that this article is understood to apply to any form of compensation for employment, including payments in kind, regardless of whether the remuneration could be characterized as salaries or wages.

The proposed treaty provides that remuneration derived in respect of employment exercised aboard a ship or aircraft operated by an enterprise of a country in international traffic may be taxed in the country in which the enterprise is resident. A similar rule is contained in the U.N. and OECD models.

This article is subject to the provisions of the separate articles covering directors' fees (Article 17), pensions and social security payments (Article 20), government service income (Article 21), income of students and trainees (Article 22), and income of teachers (Article 23).

Article 17. Directors' Fees

Under the proposed treaty, directors' fees and other similar payments derived by a resident of one country in his or her capacity as a member of the board of directors of a company (or as a designee of a director serving in the capacity of a director) which is a resident of that other country may be taxed in that other country, unless the services are performed in the first country. This treatment is unlike the U.S. model, which provides that the country where the director resides continues to have sole taxing jurisdiction over remuneration derived from services performed outside the country of residence of the corporation of which the individual is a director.

Article 18. Limitation on Benefits

In general

The proposed treaty contains a provision generally intended to limit the indirect use of the proposed treaty by persons who are not entitled to its benefits by reason of residence in the United States or Thailand. The proposed treaty is intended to limit double taxation caused by the interaction of the tax systems of the United States and Thailand as they apply to residents of the two countries. At times, however, residents of third countries attempt to use a treaty. This use is known as "treaty shopping," which refers to the situation where a person who is not a resident of either treaty country seeks certain benefits under the income tax treaty between the two countries. Under certain circumstances, and without appropriate safeguards, the third-country resident may be able to secure these benefits indirectly by establishing a corporation or other entity in one of the treaty countries, which entity, as a resident of that country, is entitled to the benefits of the treaty. Additionally, it may be possible for the third-country resident to reduce the income base of the treaty country resident by having the latter pay out interest, royalties, or other amounts under favorable conditions either through relaxed tax provisions in the distributing country or by passing the funds through other treaty countries until the funds can be repatriated under favorable terms.

The proposed anti-treaty-shopping article provides that a person that is a resident of either Thailand or the United States and that derives income from the other treaty country is entitled to all the benefits of the proposed treaty only if such person is:

(1) an individual;
(2) one of the treaty countries or a political subdivision or local authority thereof;
(3) a person that satisfies an ownership and base erosion test;
(4) a company that satisfies a public company test;
(5) a company that is owned by certain public companies; or
(6) an entity that is a not-for-profit tax-exempt organization that satisfies an ownership test.

Alternatively, a resident that does not fit into any of the above categories may claim treaty benefits with respect to certain items of income under the active business test. In addition, a person that does not satisfy any of the above requirements may be granted the benefits of the proposed treaty if the source country's competent authority so determines.

The proposed treaty provides that a Thai resident that is an "international banking facility" as that term is defined under the laws of Thailand (or any other Thai resident that is subject to the same tax treatment under Thai law as an international banking facility) is not entitled to any U.S. benefits under the proposed treaty with respect to any income that such facility receives from the United States.

Ownership and base erosion tests

Under the ownership test, more than 50 percent of the beneficial interest in an entity (or, in the case of a company, more than 50 percent of the number of shares of each class of the company's

shares) must be owned, directly or indirectly, by one or more individual residents of Thailand or the United States, citizens of the United States, the countries themselves, political subdivisions or local authorities of the countries, certain publicly traded companies and subsidiaries of publicly traded companies (as described in the discussion of the public company tests below), or certain tax-exempt organizations (as described in the discussion of tax-exempt entities below). This rule could, for example, deny the benefits of the reduced U.S. withholding tax rates on dividends and royalties paid to a Thai company that is controlled by individual residents of a third country. This rule is similar, but not identical, to a corresponding rule in the U.S. model. In addition, the base erosion test is met only if more than 50 percent of the gross income of the entity is *not* used, directly or indirectly, to meet liabilities (including liabilities for interest or royalties) to persons or entities other than those referred to in the preceding paragraph. This rule is intended to prevent a corporation, for example, from distributing most of its income, in the form of deductible items such as interest, royalties, service fees, or other amounts) to persons not entitled to benefits under the proposed treaty. This treatment is similar to the corresponding rule in the U.S. model.

Public company tests

Under the public company tests, a company that is a resident of Thailand or the United States is entitled to the benefits of the proposed treaty if there is substantial and regular trading in its principal class of shares on a recognized stock exchange, regardless of where its actual owners reside or the amount or destination of payments it makes. This test is similar to the rule contained in the U.S. model. The Technical Explanation states that the term "principal class of shares" is to be interpreted as the class of shares that represents the majority of the voting power and value of the company. The Technical Explanation also states that the term "substantial and regular trading," although not defined in the proposed treaty, will be defined by reference to the domestic laws of the country from which treaty benefits are being sought. In the case of the United States, this term is understood to have the meaning given "regularly traded" in Treas. Reg. sec. 1.884–5(d)(4)(i)(B), relating to the branch tax provisions of the Code.

Similarly, treaty benefits are available to a company that is a resident of Thailand or the United States and that is wholly owned (directly or indirectly) by a company that satisfies the public company test just described, provided that each company in the chain of ownership used to satisfy the control requirements is a resident of Thailand or the United States. Under the U.S. model, at least 50 percent of each class of shares in a company must be owned directly or indirectly by a company that satisfies a similar public company test as described above. Thus, the wholly owned requirement in the proposed treaty for companies owned by publicly traded companies generally is more stringent than the corresponding ownership requirement in the U.S. model.

The term "recognized stock exchange" means the NASDAQ System owned by the National Association of Securities Dealers, Inc.; any stock exchange registered with the Securities and Exchange

Commission as a national securities exchange for the purposes of the Securities Exchange Act of 1934; any securities exchange recognized by the Securities and Exchange Commission of Thailand; and any other stock exchange agreed upon by the competent authorities of the two countries.

Tax-exempt entities

An entity is entitled to benefits under the proposed treaty if it is a not-for-profit organization that, by virtue of that status, generally is exempt from income taxation in its treaty country of residence, provided that more than half of its beneficiaries, members or participants, if any, are entitled under this article to the benefits of the proposed treaty. Unlike the proposed treaty, the U.S. model does not contain an ownership requirement for such tax-exempt organizations.

Active business test

In general

Under the active business test, treaty benefits are available under the proposed treaty to an entity that is a resident of one of the treaty countries with respect to income from the other country if the entity is engaged in the active conduct of a trade or business in its residence country and if (1) the income is derived in connection with that trade or business, and that trade or business substantial in relation to the income-generating activity in the other country, or (2) the income is incidental to the trade or business in the recipient's residence country. Under the U.S. model, the trade or business in the residence country must also be "substantial" in cases where the income derived in the other country is "incidental" to the trade or business of the residence country. The proposed treaty does not apply a substantiality test to such incidental income.

The term "trade or business" is not specifically defined in the proposed treaty. However, as provided in Article 3 (General Definitions), undefined terms are to have the meaning which they have under the laws of the country applying the proposed treaty. In this regard, the Technical Explanation states that the U.S. competent authority will refer to the regulations issued under Code section 367(a) to define an active trade or business. Under the proposed treaty, the active business test does not apply (and benefits therefore may be denied) to the business of making or managing investments, unless these activities are banking or insurance activities carried on by a bank or insurance company. The Technical Explanation states these rules do not apply to a headquarters company, because the company would not be considered to be engaged in an active trade or business.

Income derived in connection with a trade or business that is substantial

The Technical Explanation states that an item of income is derived in connection with a trade or business if the income-producing activity in the source country is a line of business which forms a part of, or is complementary to, the trade or business conducted

in the residence country.[9] This rule is similar to the rule in the U.S. model. The Technical Explanation states that it is intended that a business activity generally will be considered to "form a part of" a business activity conducted in the other country if the two activities involve the design, manufacture or sale of the same products or type of products, or the provision of similar services. The Technical Explanation further states that in order for activities to be "complementary," the activities need not relate to the same types of products or services, but they should be part of the same overall industry and be related in the sense that success or failure of one activity will tend to result in the success or failure of the other activity. The Technical Explanation provides several examples illustrating these principles.

The proposed treaty provides that whether a trade or business of a resident is substantial is determined based on all the facts and circumstances. According to the Technical Explanation, the factors to be considered include the relative scale of the activities conducted in the two countries, and the relative contributions made to the conduct of the trade or business in both countries.[10]

Income incidental to a trade or business

The Technical Explanation states that it is understood that income is incidental to a trade or business conducted in the other country if the production of such income facilitates the conduct of a trade or business in the other country. This rule is the same as the rule in the U.S. model. As an example, the Technical Explanation states that incidental income includes the temporary investment of working capital derived from a trade or business.

Grant of treaty benefits by the competent authority

Finally, the proposed treaty provides a "safety-valve" for a person that has not established that it meets one of the other more objective tests, but for which the allowance of treaty benefits would not give rise to abuse or otherwise be contrary to the purposes of the treaty. Under this provision, such a person may be granted treaty benefits if the competent authority of the source country so determines. The corresponding article in the U.S. model contains a similar rule. According to the Technical Explanation, the competent authorities will base such a determination on whether the establishment, acquisition, or maintenance of the person, or the conduct of its operations, has or had as one of its principal purposes the obtaining of treaty benefits.

Other rules

The proposed treaty provides that if income arising in one of the countries is relieved in whole or in part from tax in that country, and a person is subject to tax in respect of such income under the

[9] Cf. Treas. Reg. sec. 1.884–5(e)(1) (To satisfy the active business test, the activities that give rise to the U.S. income must be part of a U.S. business and that business must be an integral part of an active trade or business conducted by the foreign corporation in its residence country.).

[10] Cf. Treas. Reg. sec. 1.884–5(e)(3) (A foreign corporation engaged in business in its residence country has a substantial presence in that country if certain of the attributes of that business, physically located in its residence country, equal at least a threshold percentage of its worldwide attributes.).

law in force of the other country by reference to the amount of the income which is remitted to or received in that other country, and not by reference to the full amount of the income, then the relief to be allowed under the proposed treaty in the country in which the income arises will apply only to the portion of the income that is remitted to or received in the other country during the calendar year such income accrues or the next succeeding year.

The proposed treaty also provides that the competent authorities of the countries will exchange such information as is necessary to carry out the provisions of this article.

Article 19. Artistes and Sportsmen

Like the U.S., OECD and U.N. models, the proposed treaty contains a separate set of rules that apply to the taxation of income earned by entertainers (such as theater, motion picture, radio, or television "artistes" or musicians) and sportsmen. These rules apply notwithstanding the other provisions dealing with the taxation of income from personal services (Articles 15 and 16) and are intended, in part, to prevent entertainers and sportsmen from using the proposed treaty to avoid paying any tax on their income earned in one of the countries.

Under the proposed treaty, income derived by an entertainer or sportsman who is a resident of one country from his or her personal activities as such in the other country may be taxed in the other country if the amount of the gross receipts derived by him or her from such activities exceeds the lesser of (1) $100 or its Thai currency equivalent per day, or (2) $3,000 or its Thai currency equivalent in the aggregate for the entire taxable year concerned. Under this rule, if a Thai entertainer or sportsman maintains no fixed base in the United States and performs (as an independent contractor) for one day of a taxable year in the United States for total compensation of $200, the full amount would be subject to U.S. tax.

The proposed treaty provides that where income in respect of activities exercised by an entertainer or sportsman in his or her capacity as such accrues not to the entertainer or sportsman but to another person, that income of that other person is taxable by the country in which the activities are exercised, unless it is established that neither the entertainer or sportsman nor persons related to him or her participated directly or indirectly in the profits of that other person in any manner, including the receipt of deferred remuneration, bonuses, fees, dividends, partnership distributions, or other distributions. (This provision applies notwithstanding the business profits and personal services articles (Articles 7, 15 and 16).) This provision prevents highly-paid entertainers and sportsmen from avoiding tax in the country in which they perform by, for example, routing the compensation for their services through a third entity such as a personal holding company or a trust located in a country that would not tax the income.

The proposed treaty provides that these rules do not apply to remuneration, or profits, salaries, wages and similar income derived from activities performed in a country by public entertainers if the visit to that country is substantially supported by public funds of the other country, including any of its political subdivisions or local

authorities. This rule is not contained in the U.S., OECD or U.N. models, but is contained in some other U.S. treaties.

Article 20. Pensions and Social Security Payments

Under the proposed treaty, pensions and other similar remuneration paid to a resident of either country in consideration of past employment is subject to tax only in the recipient's country of residence. The Technical Explanation states that, for purposes of this rule, the pension may be paid periodically or in a lump sum. This rule is subject to the provisions of Article 21 (Government Service) with respect to pensions.

The proposed treaty provides that social security benefits and other similar public pensions paid by a country to a resident of the other country or to a U.S. citizen are taxable only by the payor's country, and not by the recipient's country of residence. According to the Technical Explanation, the phrase "similar public pension" is intended to include United States tier 1 Railroad Retirement benefits. Consistent with the U.S. model, this rule with respect to social security payments is an exception to the proposed treaty's saving clause.

The proposed treaty also provides that annuities are taxed only in the country of residence of the person that beneficially owns and derives them. This rule is similar to the rule in the U.S. model. The term "annuities" is defined for purposes of this provision as a stated sum paid periodically at stated times during a specified number of years, under an obligation to make the payments in return for adequate and full consideration (other than services rendered).

The proposed treaty provides that alimony paid to a resident of a country is taxable only in the recipient's country of residence. For purposes of the proposed treaty, the term "alimony" means periodic payments made pursuant to a written separation agreement or a decree of divorce, separate maintenance or compulsory support, which payments are taxable under the laws of the country in which the recipient is a resident. This rule is similar to the rule contained in the U.S. model.

The proposed treaty provides that child support payments made by a resident of a country to a resident of the other country are taxable only in the payor's country of residence. This rule is different from the rule in the U.S. model, which provides that child support payments are exempt from tax in both countries. For these purposes, child support payments are periodic payments, not treated as alimony payments, for the support of a child made pursuant to a written separation agreement, or a decree of divorce, separate maintenance or compulsory support.

Article 21. Government Service

The proposed treaty provides rules with respect to the tax treatment of income (including pensions) from governmental employment. The provisions generally follow the corresponding provisions in the U.S., OECD and U.N. models.

Under the proposed treaty, remuneration, other than a pension, paid by one of the countries (or a political subdivision or local authority thereof) to an individual in respect of services rendered to

that country (or subdivision or authority) generally is taxable only by that country. Such remuneration is taxable only by the other country, however, if the services are rendered in that other country by an individual who is a resident of that country and who (1) is also a national of that country or (2) did not become a resident of that country solely for the purpose of rendering the services.

The proposed treaty further provides that any pension paid by, or out of funds created by, one of the countries (or a political subdivision or local authority thereof) to an individual in respect of services rendered to that country (or subdivision or authority) is taxable only by that country. Such a pension is taxable only by the other country, however, if the individual is a national and resident of that other country.

The provisions described in the foregoing paragraphs are exceptions to the proposed treaty's saving clause for individuals who are neither citizens nor permanent residents of the country where the services are performed. Thus, for example, payments by the government of Thailand to its employees in the United States are exempt from U.S. tax if the employees are not U.S. citizens or green card holders and were not residents of the United States at the time they became employed by the Thai government.

The proposed treaty provides that if a country or one of its political subdivisions or local authorities is carrying on business (as opposed to functions of a governmental nature), the provisions of Articles 16 (Dependent Personal Services), 17 (Directors' Fees), and 20 (Pensions and Social Security Payments) apply to remuneration and pensions paid for services rendered in connection with the business.

Article 22. Students and Trainees

The proposed treaty provides rules with respect to the taxation of income of students and trainees. The provisions of this article differ substantially from the provisions in the U.S., OECD and U.N. models.

Under the proposed treaty, an individual who is a resident of a country (the residence country) at the time he or she becomes temporarily present in the other country (the host country) will be exempt from tax by the host country for certain amounts received by the individual, if the individual's visit in the host country was for the primary purpose of (1) studying at a university or other recognized educational institution in the host country, (2) securing training required to qualify such individual to practice a profession or professional specialty, or (3) studying or doing research as a recipient of a grant, allowance or award from a government, religious, charitable, scientific, literary or educational organization. In such cases, the individual will be exempt from host country tax for a period not exceeding five taxable years from the date of the individual's arrival in the host country in respect of (1) gifts from abroad for the purpose of maintenance, education, study, research, or training, (2) a grant, allowance or award, and (3) income from personal services performed in the host country in an amount not to exceed $3,000 or its Thai currency equivalent for any taxable year. The Technical Explanation states that a gift will be considered to be made from abroad if the payor is located outside the host coun-

try. The Technical Explanation states that the term "primary purpose" (as referred to above) is meant to describe individuals participating in a full-time program of study, training or research. [11]

The proposed treaty provides that the benefits described under the foregoing paragraph, as well as the benefits provided to teachers under Article 23, may, when taken together, extend for a period of time not to exceed five taxable years from the date of the individual's arrival in the host country, as may reasonably or customarily be required to effectuate the purpose of the visit. In addition, the benefits provided to teachers under Article 23 are not available to an individual, if during the immediately preceding period, such individual enjoyed the benefits described in the foregoing paragraph.

Under the proposed treaty, an individual who is a resident of one country at the time he or she becomes temporarily present in the other country as an employee of, or under contract with, a resident of the first country, will be exempt from tax by the host country for certain amounts received by the individual, if the individual's visit in the host country was for the primary purpose of (1) acquiring technical, professional, or business experience from a person other than that resident of the first country or a person related to that resident, or (2) studying at a university or other recognized educational institution in the host country. In such cases, the individual will be exempt from tax by the host country for a period not exceeding 12 consecutive months with respect to his or her income from personal services in an aggregate amount which does not exceed $7,500 or its Thai currency equivalent (not including reimbursed expenses).

Under the proposed treaty, an individual who is a resident of one country at the time he or she becomes temporarily present in the other country for a period not exceeding one year, as a participant in a program sponsored by the Government of the host country, for the primary purpose of training, research or study, is exempt from tax by the host country with respect to income from personal services in respect of such training, research or study performed in the host country. This exemption from host country tax applies to an amount that may not exceed, in the aggregate, $10,000 or its Thai currency equivalent in any taxable year (not including reimbursed expenses).

The provisions described in the foregoing paragraphs are exceptions to the proposed treaty's saving clause for individuals who are neither citizens nor permanent residents of the host country. Thus, for example, a person who is not a U.S. citizen, and who visits the United States as a student and remains long enough to become a resident under U.S. law, but does not become a permanent resident, will be entitled to the full benefits of this article.

Article 23. Teachers

The proposed treaty provides rules with respect to the taxation of income earned by teachers. The U.S., OECD and U.N. models do not contain similar provisions.

[11] The Technical Explanation states that it is not the intention to exclude full-time students who, in accordance with their visas, may hold part-time employment jobs.

Under the proposed treaty, a teacher or instructor who, immediately before visiting a country (the host country), was a resident of the other country and who is present in the host country for a period not exceeding two years for the purposes of teaching or engaging in research at a university, college or other recognized educational institution in the host country, is not taxable in the host country on any remuneration for such teaching or research, for a period not exceeding two years from the date he or she first visits the host country for such purpose.

The proposed treaty provides that this article applies to income from research only if such research is undertaken by the individual in the public interest and not primarily for the benefit of some other private person or persons.

This article of the proposed treaty is an exception from the saving clause in the case of persons who are neither citizens nor lawful permanent residents of the host country.

Article 24. Other Income

This article is a catch-all provision intended to cover items of income not specifically covered in other articles, and to assign the right to tax income from third countries to either the United States or Thailand. As a general rule, items of income not otherwise dealt with in the proposed treaty which are derived by residents of one of the countries are taxable only in the country of residence.

This rule, for example, gives the United States the sole right under the proposed treaty to tax income derived from sources in a third country and paid to a U.S. resident. This article is subject to the saving clause, so U.S. citizens who are residents of Thailand will continue to be taxable by the United States on their third-country income.

The general rule just stated does not apply to income (other than income from real property as defined in Article 6) if the beneficial owner of the income is a resident of one country and carries on business in the other country through a permanent establishment, or performs services in the other country from a fixed base, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment or fixed base. In such a case, the provisions of Article 7 (Business Profits) or Article 15 (Independent Personal Services), as the case may be, will apply. Under the proposed treaty, such exception also applies where the income is received after the permanent establishment or fixed base is no longer in existence, but the income is attributable to the former permanent establishment or fixed base.

The proposed treaty provides that notwithstanding the foregoing rules, items of income of a resident of a country not dealt with in the other articles of the proposed treaty and arising in the other country, may also be taxed by that other country. This rule, which is not contained in the U.S. and OECD models, is similar to the corresponding rule in the U.N. model.

Article 25. Relief from Double Taxation

Internal taxation rules

United States

The United States taxes the worldwide income of its citizens and residents. It attempts unilaterally to mitigate double taxation generally by allowing taxpayers to credit the foreign income taxes that they pay against U.S. tax imposed on their foreign-source income. An indirect or "deemed-paid" credit is also provided. Under this rule, a U.S. corporation that owns 10 percent or more of the voting stock of a foreign corporation and that receives a dividend from the foreign corporation (or an inclusion of the foreign corporation's income) is deemed to have paid a portion of the foreign income taxes paid (or deemed paid) by the foreign corporation on its earnings. The taxes deemed paid by the U.S. corporation are included in its total foreign taxes paid for the year the dividend is received.

Thailand

Under Thai law, the relevant taxes paid to foreign countries generally are deductible expenses of a Thai corporation. Generally no specific foreign tax relief is provided for Thai resident individuals.

Proposed treaty limitations on internal law

One of the two principal purposes for entering into an income tax treaty is to limit double taxation of income earned by a resident of one of the countries that may be taxed by the other country. Unilateral efforts to limit double taxation are imperfect. Because of differences in rules as to when a person may be taxed on business income, a business may be taxed by two countries as if it were engaged in business in both countries. Also, a corporation or individual may be treated as a resident of more than one country and be taxed on a worldwide basis by both.

The double tax issue is addressed in part in other articles of the proposed treaty that limit the right of a source country to tax income. This article provides further relief where both Thailand and the United States otherwise still tax the same item of income. This article is not subject to the saving clause, so that the country of citizenship or residence will waive its overriding taxing jurisdiction to the extent that this article applies.

In the case of the United States, the proposed treaty generally provides that the United States will allow a U.S. citizen or resident a foreign tax credit for the income taxes imposed by Thailand. The proposed treaty also requires the United States to allow a deemed-paid credit, with respect to Thai income tax, to any U.S. company that receives dividends from a Thai company if the U.S. company owns 10 percent or more of the voting stock of such Thai company. The credit generally is to be computed in accordance with the provisions and subject to the conditions and limitations of U.S. law (as such law may be amended from time to time without changing the general principles of the proposed treaty provisions). The diplomatic notes provide that the term "conditions" is intended to make clear that U.S. rules regarding dual capacity taxpayers apply in determining the extent to which the Thailand petroleum income tax

will be considered an income tax for purposes of the relief from double taxation article (Article 25). The proposed treaty provides that the Thai taxes referred to in Article 2 (Taxes Covered) are considered income taxes for purposes of the foregoing rules.

In the case of Thailand, the proposed treaty generally provides that U.S. tax payable in respect of U.S.-source income is allowed as a credit against Thai tax payable on such income. The credit may not exceed the portion of the pre-credit amount of Thai tax which is appropriate to such income. The allowance of this credit is subject to the provisions of Thai tax law regarding credit for foreign taxes (as such law may be amended from time to time without changing the general principles of this treaty provision). The proposed treaty provides that these rules regarding the creditability of U.S. taxes for Thai tax purposes will not apply in the case of income that has been denied the benefits of the proposed treaty under the limitation on benefits article (Article 18).

For purposes of implementing the proposed treaty's foreign tax credit, the proposed treaty provides source rules for determining the country in which an item of income is deemed to have arisen. Under these rules, income derived by a resident of one of the countries that may be taxed in the other country in accordance with the proposed treaty (other than solely by reason of citizenship) is treated as arising in that other country. However, the preceding rule does not override the source rules of the domestic laws of countries that are applicable for purposes of limiting the foreign tax credit. In addition, income derived by a resident of one of the countries that may not be taxed in the other country in accordance with the proposed treaty is treated as arising in the resident's country of residence. Notwithstanding these rules, the proposed treaty provides that the determination of the source of income for purposes of this article will be subject to such source rules in the domestic laws of the country as apply for the purpose of limiting the foreign tax credit. The proposed treaty clarifies that these rules do not apply in determining foreign tax credits in a country for foreign taxes other than the taxes of the other country referred to in Article 2 (Taxes Covered).

The diplomatic notes provide that it is understood that if the United States alters its policy regarding the provision of a tax sparing credit, or if the United States reaches an agreement on the provision of a tax sparing credit with any other country, the United States will agree to reopen negotiations with Thailand with a view to concluding a protocol which would provide a similar tax sparing credit to Thailand.

Article 26. Non-Discrimination

The proposed treaty contains a non-discrimination article that is generally similar to the non-discrimination article in the U.S. model and to provisions that have been included in other recent U.S. income tax treaties. Under the U.S. model, however, non-discrimination protection is provided with respect to all taxes imposed by a country or its political subdivisions or local authorities. Unlike the U.S. model, this article applies only to taxes covered by the proposed treaty under Article 2 (Taxes Covered).

In general, under the proposed treaty, one country may not discriminate by imposing other or more burdensome taxes (or requirements connected with taxes) on nationals of the other country than it would impose on its nationals in the same circumstances. This provision applies whether or not the nationals in question are residents of the United States or Thailand.

Under the proposed treaty, neither country may tax a permanent establishment of an enterprise of the other country less favorably than it taxes its own enterprises carrying on the same activities. Consistent with the U.S., OECD and U.N. models, however, a country is not obligated to grant residents of the other country any personal allowances, reliefs, or reductions for tax purposes on account of civil status or family responsibilities which it grants to its own residents.

The proposed treaty explicitly provides that nothing in the nondiscrimination article is to be construed as preventing either of the countries from imposing a branch profits tax.

Each country is required (subject to the arm's-length pricing rules of Articles 9 (Associated Enterprises), 11 (Interest), and 12 (Royalties)) to allow its residents to deduct interest, royalties, and other disbursements paid by them to residents of the other country under the same conditions that it allows deductions for such amounts paid to residents of the same country as the payor. The Technical Explanation states that the term "other disbursements" is understood to include a reasonable allocation of executive and general administrative expenses, research and development expenses, and other expenses incurred for the benefit of a group of related persons. The Technical Explanation further states that the so-called "earnings-stripping" rules of section 163(j) of the Code are not discriminatory within the meaning of this provision.

The nondiscrimination rules also apply to enterprises of one country that are owned in whole or in part by residents of the other country. Enterprises resident in one country, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other country, will not be subjected in the first country to any taxation or any connected requirement which is other or more burdensome than the taxation and connected requirements that the first country imposes or may impose on its similar enterprises. The Technical Explanation includes examples of Code provisions that are understood by the two countries not to violate this provision of the proposed treaty. Those examples cover the rules that impose a withholding tax on non-U.S. partners of a partnership and the rules that prevent foreign persons from owning stock in Subchapter S corporations.

The saving clause (which allows the country of residence or citizenship to impose tax notwithstanding certain treaty provisions) does not apply to the nondiscrimination article.

Article 27. Mutual Agreement Procedure

The proposed treaty contains the standard mutual agreement provision, with some variation, that authorizes the competent authorities of the two countries to consult together to attempt to alleviate individual cases of double taxation not in accordance with the proposed treaty. The saving clause of the proposed treaty does not

apply to this article, so that the application of this article might result in a waiver (otherwise mandated by the proposed treaty) of taxing jurisdiction by the country of citizenship or residence.

Under this article, a resident of one country who considers that the action of one or both of the countries will cause him or her to be subject to tax which is not in accordance with the proposed treaty may present his or her case to the competent authority of the country of which he or she is a resident or, if the case comes under the non-discrimination article (Article 26), to the competent authority of the country in which he or she is a national. Similar to the OECD and U.N. models, and unlike the U.S. model, the proposed treaty provides that the case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the proposed treaty.

The competent authority then makes a determination as to whether the objection appears justified. If the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, that competent authority endeavors to resolve the case by mutual agreement with the competent authority of the other country, with a view to the avoidance of taxation which is not in accordance with the proposed treaty.

The competent authorities of the countries must endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the proposed treaty. In particular, the competent authorities may agree to increase any specific amounts referred to in the proposed treaty to reflect economic or monetary developments. The competent authorities may also consult together for the elimination of double taxation in cases not provided for in the proposed treaty. The Technical Explanation states that the competent authorities may agree on other matters, including the attribution of income, deductions, credits, or allowances of an enterprise of one treaty country to the enterprise's permanent establishment in the other country; advance pricing arrangements; the characterization of particular items of income; the characterization of persons; the application of source rules with respect to particular items of income; the application of provisions of each country's internal law regarding penalties, fines, and interest; uniform standards for the use of exchange rates; and consistent timing of gain recognition with respect to a transaction to avoid double taxation.

The proposed treaty provides that in the event that the competent authorities reach an agreement under this article, taxes will be imposed on such income, and refund or credit of taxes will be allowed by the countries in accordance with such agreement.

The proposed treaty authorizes the competent authorities to communicate with each other directly for purposes of reaching an agreement in the sense of this mutual agreement article. This provision makes clear that it is not necessary to go through diplomatic channels in order to discuss problems arising in the application of the proposed treaty.

Article 28. Exchange of Information

This article provides for the exchange of information between the two countries. Notwithstanding the provisions of Article 2 (Taxes

Covered), the proposed treaty's information exchange provisions apply to all taxes imposed by the United States under the Code, and in the case of Thailand, to all taxes imposed under the Thai Revenue Code and the Thai Petroleum Income Tax Act.

The proposed treaty provides that the two competent authorities will exchange such information as is necessary to carry out the provisions of the proposed treaty or the provisions of the domestic laws of the two countries concerning taxes to which the proposed treaty applies (provided that the taxation under those domestic laws is not contrary to the proposed treaty). This exchange of information is not restricted by Article 1 (Personal Scope). Therefore, information with respect to third-country residents is covered by these procedures.

Any information exchanged under the proposed treaty will be treated as secret in the same manner as information obtained under the domestic laws of the country receiving the information. The exchanged information may be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment, collection, or administration, enforcement, or prosecution in respect of, or the determination of appeals in relation to, the taxes to which the proposed treaty would apply. Such persons or authorities may use the information for such purposes only.[12] The Technical Explanation states that persons involved in the administration of taxes include legislative bodies with oversight roles with respect to the administration of the tax laws, such as, for example, the tax-writing committees of Congress and the General Accounting Office. Exchanged information may be disclosed in public court proceedings or in judicial decisions.

As is true under the U.S., OECD and U.N. models, under the proposed treaty, a country is not required to carry out administrative measures at variance with the laws and administrative practice of either country, to supply information that is not obtainable under the laws or in the normal course of the administration of either country, or to supply information that would disclose any trade, business, industrial, commercial, or professional secret or trade process or information the disclosure of which would be contrary to public policy.

Subject to the termination article (Article 31), the proposed treaty provides that if information is requested by a country in accordance with the exchange of information article, the requested country will obtain the information to which the request relates in the same manner and to the same extent as if the tax were its own tax. The Technical Explanation states that this rule applies even if the requested country has no direct tax interest in the case to which the tax relates. However, the proposed treaty provides that the application of this rule will be suspended until such time as the U.S. Government receives from the Thai Government a diplomatic note indicating that Thailand is prepared and able to implement this provision. The Technical Explanation states that it is understood that Thailand will not be prepared and able to implement

[12] Code section 6103 provides that otherwise confidential tax information may be utilized for a number of specifically enumerated non-tax purposes. Information obtained by the United States pursuant to the proposed treaty could not be used for these non-tax purposes.

this provision until enabling legislation has been enacted and becomes effective.

Article 29. Diplomatic Agents and Consular Officers

The proposed treaty contains the rule found in the U.S. model and other U.S. tax treaties that its provisions do not affect the fiscal privileges of diplomatic agents or consular officers under the general rules of international law or the provisions of special agreements. Accordingly, the proposed treaty will not defeat the exemption from tax which a host country may grant to the salary of diplomatic officials of the other country. The saving clause does not apply in the application of this article to host country residents who are neither citizens nor lawful permanent residents of that country. Thus, for example, U.S. diplomats who are considered Thai residents generally may be protected from Thai tax.

Article 30. Entry Into Force

This article provides for the ratification of the proposed treaty in accordance with the applicable procedures of each country, and for the exchange of instruments of ratification at Washington DC. The proposed treaty will enter into force on the date the instruments of ratification are exchanged.

With respect to taxes withheld at source, the proposed treaty will be effective for amounts paid or credited on or after the first day of the sixth month next following the date on which the proposed treaty enters into force.

With respect to other taxes, the proposed treaty will be effective for taxable periods beginning on or after the first day of January next following the date on which the proposed treaty enters into force.

Article 31. Termination

The proposed treaty will continue in force until terminated by either country. Either country may terminate the proposed treaty at any time after the expiration of the five-year period from the date of its entry into force, provided that at least six months prior notice of termination has been given through diplomatic channels. A termination is effective, with respect to taxes withheld at source for amounts paid or credited on or after the first day of January next following the expiration of the six month notification period. In the case of other taxes, a termination is effective for taxable periods beginning on or after the first day of January next following the expiration of the six month notification period.

Notwithstanding the above rules, the proposed treaty will terminate on January 1 of the sixth year following its entry into force, unless the U.S. Government has received from the Thai Government by the preceding June 30th, a diplomatic note as described in the exchange of information article (Article 28), indicating that Thailand is prepared to implement the provision relating to obtaining information upon request described in paragraph 3 of that article.

IX. Text of the Resolution of Ratification

Resolved, (two-thirds of the Senators present concurring therein), That the Senate advise and consent to the ratification of the Convention between the Government of the United States of America and the Government of the Kingdom of Thailand for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, signed at Bangkok, November 26, 1996 (Treaty Doc. 105–2), subject to the declaration of subsection (a), and the proviso of subsection (b).

(a) DECLARATION.—The Senate's advice and consent is subject to the following declaration, which shall be binding on the President:

(1) TREATY INTERPRETATION.—The Senate affirms the applicability to all treaties of the constitutionally based principles of treaty interpretation set forth in Condition (1) of the resolution of ratification of the INF Treaty, approved by the Senate on May 27, 1988, and Condition (8) of the resolution of ratification of the Document Agreed Among the States Parties to the Treaty on Conventional Armed Forces in Europe, approved by the Senate on May 14, 1997.

(b) PROVISO.—The resolution of ratification is subject to the following proviso, which shall be binding on the President:

(1) SUPREMACY OF THE CONSTITUTION.—Nothing in the Treaty requires or authorizes legislation or other action by the United States of America that is prohibited by the Constitution of the United States as interpreted by the United States.

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