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Opening Statement of Robert B. Stack
Treasury Deputy Assistant Secretary (International Tax Affairs)
Senate Committee on Foreign Relations
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Chairman Cardin, Ranking Member Barrasso, and distinguished Members of the Committee, I appreciate the opportunity to appear today to recommend, on behalf of the Administration, favorable action on five tax treaties pending before this Committee. We appreciate the Committee's interest in these treaties and in the U.S. tax treaty network overall.

This Administration is committed to eliminating barriers to cross-border trade and investment, and tax treaties are one of the primary means for eliminating such tax barriers. Tax treaties provide greater certainty to businesses and individuals regarding their potential liability to tax in foreign jurisdictions, and they allocate taxing rights between jurisdictions to reduce the risk of double taxation. Tax treaties also ensure that businesses and individuals are not subject to discriminatory taxation in foreign jurisdictions.

A tax treaty reflects a balance of benefits that is agreed to when the treaty is negotiated. In some cases, changes in law or policy in one or both of the treaty partners make the partners more willing to increase the benefits beyond those provided in an existing treaty; in these cases, revisions to a treaty may be very beneficial. In other cases, developments in one or both countries, or international developments more generally, may make it desirable to revisit an existing treaty to prevent improper exploitation of treaty provisions and eliminate unintended and inappropriate consequences in the application of the treaty. In yet other cases, the United States seeks to establish new income tax treaties with countries in which there is significant U.S. direct investment, and with respect to which U.S. companies are experiencing double taxation that is not otherwise relieved by domestic law remedies, such as the U.S. foreign tax credit. Both in setting our overall negotiation priorities and in negotiating individual treaties, our focus is on ensuring that our tax treaty network fulfills its goals of facilitating-cross border trade and investment and preventing tax evasion.

Additionally, our tax treaties have long played an important role in helping to prevent tax evasion. A key element of U.S. tax treaties is exchange of information between tax authorities. Under tax treaties, one country may request from the other such information that is foreseeably relevant for the proper administration of the first country's tax laws. Because access to information from other countries is critically important to the full and fair enforcement of U.S. tax laws, information exchange has long been a top priority for the United States in its tax treaty program. I would like to emphasize to the Committee that as we establish exchange of information relationships, the Administration places a high priority on ensuring that any information exchanged will be strictly protected by our treaty partners. The United States will only exchange tax information with a country if we are satisfied that the county will protect the information we have provided.

The proposed tax treaties before the Committee today are with Chile, Hungary, Luxembourg and Switzerland, in addition to the proposed protocol to the Convention on Mutual Administrative Assistance in Tax Matters (the "Multilateral Convention"), and each serves to further the goals of our tax treaty network. The proposed tax treaty with Chile would be the first tax treaty between the United States and Chile, which the U.S. business community has been calling for. The proposed tax treaty with Hungary would replace an existing treaty the revision of which has been a top tax treaty priority for the Treasury Department. It contains a comprehensive "limitation on benefits" article designed to address possible abusive treaty shopping. The proposed protocols with Luxembourg and Switzerland modify existing tax treaty relationships. The proposed protocol to the Multilateral Convention brings the Multilateral Convention, to which the United States is a party, into conformity with the current international standards for exchanges of information between tax authorities to combat tax evasion. We urge the Committee and the Senate to take prompt and favorable action on all of these agreements.

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

<u>Purposes and Benefits of Tax Treaties</u>

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

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

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

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

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

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

Ensuring Safeguards against Abuse of Tax Treaties

A high priority for improving our overall treaty network is continued focus on prevention of "treaty shopping." The U.S. commitment to including comprehensive "limitation on benefits" provisions is one of the keys to improving our overall treaty network. Our tax treaties are intended to provide benefits to residents of the United States and residents of the particular treaty partner on a reciprocal basis. The reductions in source-country taxes agreed to in a particular treaty mean that U.S. persons pay less tax to that country on income from their investments there, and residents of that country pay less U.S. tax on income from their investments in the United States. Those reductions and benefits are not intended to flow to residents of a third country. If third-country residents are able to exploit one of our tax treaties to secure reductions in U.S. tax, such as through the use of an entity resident in a treaty country that merely holds passive U.S. assets, the benefits would flow only in one direction. That is, as third-country residents would enjoy U.S. tax reductions for their U.S. investments, but U.S. residents would not enjoy reciprocal tax reductions for their investments in that third country. Moreover, such third-country residents may be securing benefits that are not appropriate in the context of the interaction between their home countries' tax systems and policies and those of the United States. This use of tax treaties is not consistent with the balance of the deal negotiated in the underlying tax treaty. Preventing this exploitation of our tax treaties is critical to ensuring that the third country will sit down at the table with us to negotiate on a reciprocal basis so we can secure for U.S. persons the benefits of reductions in source-country tax on their investments in that country. Effective anti-treaty shopping rules also ensure that the benefits of a U.S. tax treaty are not enjoyed by residents of countries with which the United States does not have a bilateral tax treaty because that country imposes little or no tax, and thus the potential of unrelieved double taxation is low.

In this regard, the proposed tax treaty with Hungary that is before the Committee today includes a comprehensive limitation on benefits provision and represents a major step forward in protecting the U.S. tax treaty network from abuse. As was discussed in the Treasury Department's 2007 Report to the Congress on Earnings Stripping, Transfer Pricing and U.S. Income Tax Treaties, the existing income tax treaty with Hungary, signed in 1979, is one of three U.S. tax treaties that, as of 2007, provided an exemption from source-country withholding on interest payments but contained no protections against treaty shopping. The other two agreements in this category were the 1975 tax treaty with Iceland and the 1974 tax treaty with Poland. The revision of these three agreements has been a top priority for the Treasury Department's treaty program, and we have made significant progress. In 2007, we signed a new tax treaty with Iceland which entered into force in 2008. Like the proposed tax treaty with Hungary, the U.S.-Iceland tax treaty contains a comprehensive limitation on benefits provision. In addition, United States and Poland signed a new tax treaty in February 2013 that similarly contains a comprehensive limitation on benefits provision. The Administration hopes to transmit the new tax treaty with Poland to the Senate for its advice and consent soon. These achievements demonstrate that the Treasury Department has been effective in addressing concerns about treaty shopping through bilateral negotiations and amendment of our existing tax treaties.

Consideration of Arbitration

Tax treaties cannot provide a stable investment environment unless the respective tax administrations of the two countries effectively implement the treaty. Under our tax treaties, when a U.S. taxpayer becomes concerned about implementation of the treaty, the taxpayer can bring the matter to the U.S. competent authority who will seek to resolve the matter with the competent authority of the treaty partner. The competent authorities are expected to work cooperatively to resolve genuine disputes as to the appropriate application of the treaty.

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

The first U.S. tax agreement that contemplated arbitration was the U.S.-Germany income tax treaty signed in 1989 and entered into force in 1991. Tax treaties with some other countries, including Mexico and the Netherlands, incorporate authority for establishing voluntary binding arbitration procedures based on the provision in the prior U.S.-Germany treaty (although these provisions, which require an exchange of diplomatic notes to enter into force, have not been implemented). Although we believe that the presence of such voluntary arbitration provisions may have provided some limited incentive to reaching more expeditious mutual agreements, it has become clear that merely providing the ability to enter into voluntary arbitration is not nearly as effective as providing for mandatory arbitration, under certain circumstances, within the treaty itself.

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

One of the treaties before the Committee, the proposed protocol with Switzerland, includes a type of mandatory arbitration provision. This provision, in general terms, is similar to arbitration provisions in several of our recent protocols to amend treaties (Canada, Germany, Belgium and France) that have been approved by the Committee and the Senate over the last several years.

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

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

The arbitration rule in the proposed protocol with Switzerland is very similar to the arbitration rule in the tax treaty with France but differs slightly from the arbitration rules in the agreements with Canada, Germany and Belgium. This is because, in negotiating the arbitration rule in the tax treaty with France, we took into account concerns expressed by this Committee over certain aspects of the arbitration rules negotiated earlier with Canada, Germany and Belgium. Accordingly, the proposed arbitration rule with Switzerland, like the provision with France, differs from its earlier predecessors in three key respects, consistent with the Committee’s comment in its report on the Canada protocol. First, the proposed protocol with Switzerland allows the taxpayer who presented the original case that is subjected to arbitration to submit its views on the case for consideration by the arbitration panel. Second, the rule in the proposed Switzerland protocol disallows a competent authority from appointing an employee from its own tax administration to the arbitration board. Finally, the rule in the proposed Switzerland protocol does not prescribe a hierarchy of legal authorities that the arbitration panel must use in making its decision, thus ensuring that customary international law rules on treaty interpretation will apply.

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

We are hopeful that our desired objectives for arbitration are being realized, even though we are still in the early stages in our experience with arbitration and at this time cannot report definitively on the effects of arbitration on our tax treaty relationships. Our observation is that, where mandatory arbitration has been included in the treaty, the competent authorities are negotiating with greater intent to reach principled and timely resolution of disputes. Therefore, under the mandatory arbitration provision, double taxation is being effectively eliminated in a more expeditious manner.

Arbitration is a growing and developing field, and there are many forms of arbitration from which to choose. We intend to continue to study other arbitration provisions and to monitor the performance of the provisions in the agreements with Canada, Belgium, Germany and France, as well as the performance of the provision in the agreement with Switzerland, if ratified. The Internal Revenue Service has published the administrative procedures necessary to implement the arbitration rules with Germany, Belgium France and Canada. The Administration looks forward to updating the Committee on the arbitration process, in particular through the reports that are called for in the Committee's reports on the 2007 protocol to the Canada tax treaty.

In addition to the proposed protocol with Switzerland, we have concluded protocols to bilateral tax treaties with Spain and Japan that also incorporate mandatory binding arbitration. The Administration hopes to transmit those new agreements to the Senate for its advice and consent soon. We look forward to continuing to work with the Committee to make arbitration an effective tool in promoting the fair and expeditious resolution of treaty disputes.

Combating Tax Evasion and Improving Transparency through Full Exchange of Information

As noted above, effective information exchange to combat tax evasion and ensure full and fair enforcement of the tax laws has long been a top priority for the United States. A key provision found in all modern U.S. tax treaties is a rule that obligates the competent authorities of the two countries to obtain and exchange information that is foreseeably relevant to tax administration. In recent years there has been a global recognition of the need to strive for greater transparency and for full exchange of information between revenue authorities to combat tax evasion, and the United States has taken a leading role in this movement.

The proposed protocols amending the bilateral tax treaties with Switzerland and Luxembourg and the Multilateral Convention that are before the Committee today are intended to facilitate the exchange of information to prevent tax evasion and enhance transparency. These proposed protocols incorporate the current international standards for exchange of information, which require countries to obtain and exchange information for both civil and criminal matters, and which require the tax authorities to obtain and exchange information that is held by a bank or other financial institution.

The international standards on transparency and exchange of information for tax purposes are now virtually universally accepted in the global community. Indeed, all jurisdictions surveyed by the Global Forum on Transparency and Exchange of Information for Tax Purposes (the Global Forum) are now committed to implementing these standards. The Global Forum, now the largest international tax group in the world with 121 member jurisdictions and twelve observers, promotes exchange of information through a robust and comprehensive monitoring and peer review process by evaluating the compliance of jurisdictions with the international standards of transparency.

Initiated by the Organization for Economic Cooperation and Development (OECD), the Global Forum has been a driving force behind the acceptance and implementation of the international standards. The United States actively participates in the Global Forum. Treasury's Office of Tax Policy, the Office of General Counsel, and IRS Chief Counsel and Large Business and International Division have devoted substantial resources over the past two years both to the peer review of the U.S. rules and procedures and to our role as members of the Steering Group and Peer Review Group of the Forum. Since the Global Forum was reorganized in 2009, 124 peer reviews have been completed and published, and more than 1,500 agreements that provide for the exchange of tax information in accordance with the international standards have been signed throughout the world. Roughly eighty percent of the agreements which have been signed as of December 2012 are in force.

In addition, the G-20 has, for the past several years, stressed the importance of quickly implementing the international standards for transparency and exchange of information. It also requested proposals to make it easier for developing countries to secure the benefits of the new cooperative tax environment, including a multilateral approach for the exchange of information.

Against the backdrop of the Global Forum and the G-20 process, the proposed Protocol to the Multilateral Convention was adopted on May 27, 2010. The Multilateral Convention is an instrument that obligates its signatories to exchange information for tax purposes. However, because it was concluded in 1988, some of its provisions are now out of date and do not conform to the current international standards for transparency and exchange of information. In addition, the 1998 Convention is open only to member countries of either the Council of Europe or the OECD. The proposed Protocol to the Multilateral Convention conforms the existing agreement to the current international standards for exchange of information, and opens the agreement for signature and ratification by any country, provided that the Parties have provided unanimous consent. This important agreement is therefore a centerpiece to the global effort to improve transparency and foster full exchange of information between tax authorities.

Ensuring the Protection and Confidentiality of Information Exchanged with our Treaty Partners

As we modernize existing exchange of information relationships and establish new relationships, the Administration is also strongly committed to ensuring that information that we provide our treaty partners will be strictly protected and treated as confidential. One of the critical principles under today's existing international standards for information exchange upon request is that the country receiving information must ensure that exchanged information is kept confidential and only used for legitimate tax administration purposes. Consistent with this standard, the United States will not enter into an information exchange agreement unless the Treasury Department and the IRS are satisfied that the foreign government has strict confidentiality protections. Specifically, prior to entering into an information exchange agreement with another jurisdiction, the Treasury Department and the IRS closely review the foreign jurisdiction's legal framework for maintaining the confidentiality of taxpayer information. Before entering into an agreement, the Treasury Department and the IRS must be satisfied that the foreign jurisdiction has the necessary legal safeguards in place to protect exchanged information and that adequate penalties apply to any breach of that confidentiality.

Even if an information exchange agreement is in effect, the IRS will not exchange information with a country if the IRS determines that the country is not complying with its obligations under the agreement to protect the confidentiality of information and to use the information solely for collecting and enforcing taxes covered by the agreement. The IRS also will not exchange any return information with a country that does not impose tax on the income being reported, because the information could not be used for the enforcement of taxes laws within that country.

With respect to the Multilateral Convention, a Coordinating Body, on which the United States sits, has been established for the express purpose of evaluating the domestic legal framework of countries that request to join the agreement to ensure that new parties will provide confidential treatment to information received under the agreement. Countries that do not have sufficient domestic laws or legal framework to guarantee the confidentiality of taxpayer information are not permitted to sign the proposed protocol to the Multilateral Convention.

Tax Treaty Negotiating Priorities and Process

The United States has a network of 60 income tax treaties covering 68 countries. This network covers the vast majority of foreign trade and investment of U.S. businesses and investors. In establishing our negotiating priorities, our primary objective is the conclusion of tax treaties that will provide the greatest benefit to the United States and to U.S. taxpayers. We communicate regularly with the U.S. business community and the

Internal Revenue Service to seek input regarding the areas on which we should focus our treaty network expansion and improve efforts, as well as regarding practical problems encountered under particular treaties or particular tax regimes.

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

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

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

In the Treasury Department's bilateral dealing with countries around the world, we commonly conclude that the right result may be no tax treaty at all. With certain countries there simply may not be the type of cross-border tax issues that are best resolved by treaty. For example, if a country does not impose significant income taxes, there is little possibility of unresolved double taxation of cross-border income, given the fact that the United States provides foreign tax credits to its residents regardless of the existence of an income tax treaty. Under such circumstances, it would not be appropriate to enter into a bilateral tax treaty, because doing so would result in a unilateral concession of taxing rights by the United States. When instances of unrelieved double taxation cannot be identified with respect to a country, an agreement that focuses exclusively on the exchange of tax information (so-called "tax information exchange agreements" or "TIEAs") may be the more fitting agreement to conclude.

Prospective treaty partners must evidence a clear understanding of what their obligations would be under the treaty, especially those with respect to information exchange, and must demonstrate that they would be able to fulfill those obligations. Sometimes a tax treaty may not be appropriate because a potential treaty partner is unable to do so.

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

Expanding the U.S. Tax Treaty Network

While much of the Treasury Department's tax treaty negotiations involve modernizing existing agreements with key trading partners to close loopholes or improve the level of benefits to U.S. investors, we also engage with countries such as Chile to negotiate new tax treaties. The Treasury Department actively pursues opportunities to establish new tax treaty relationships with countries in which U.S. businesses encounter unrelieved double taxation with respect to their investments. The Treasury Department is aware of the keen interest of both the business community and the Senate to conclude income tax treaties with South American countries that provide meaningful benefits to cross-border investors. If approved by the Senate and the Chilean congress, the tax treaty with Chile would be the second U.S. tax treaty in force in South America: therefore, the proposed tax treaty with Chile represents a significant inroad into the South American region. In addition, the Treasury Department is engaged in bilateral tax treaty negotiations with Colombia.

The Treasury Department is also developing new tax treaty relationships in other regions of the world. For example, we have held several rounds of negotiations with Vietnam, a country that U.S. businesses have listed as a priority because they have experienced unrelieved double taxation. We hope to conclude a tax treaty, which would be the first agreement of its kind between the United States and Vietnam, in the near future.

Discussion of Proposed Treaties

I now would like to discuss the five tax treaties that have been transmitted for the Senate's consideration. The five treaties are generally consistent with modern U.S. tax treaty practice as reflected in the Treasury Department's 2006 U.S. Model Income Tax Convention. As with all bilateral tax treaties, the treaties contain some minor variations that reflect particular aspects of the treaty policies and partner countries' domestic laws and economic relations with the United States. We have submitted a Technical Explanation of each treaty that contains detailed discussions of the provisions of each treaty. These Technical Explanations serve as the Treasury Department's official explanation of each tax treaty.

Chile

The proposed Chile tax treaty is generally consistent with U.S. tax treaty policy as reflected in the United States Model Income Tax Convention of November 15, 2006 (the "U.S. Model"). There are, as with all bilateral tax treaties, some variations from these norms. In the proposed treaty, these variations from the U.S. Model reflect particular aspects of the Chilean tax system and treaty policy, the interaction of U.S. and Chilean law, and U.S.-Chile economic relations.

The proposed treaty provides for reduced source-country taxation of dividends distributed by a company resident in one country to a resident of the other country. The proposed treaty generally allows for taxation at source of 5 percent on direct dividends (i.e., where a 10-percent ownership threshold is met) and 15 percent on all other dividends. Additionally, the proposed treaty provides for an exemption from withholding tax on certain cross-border dividend payments to pension funds. In recognition of unique aspects of Chile's domestic tax system, the withholding rate reductions on dividend payments from Chile will generally not apply to Chile unless Chile makes certain modifications to its corporate tax system in the future.

Consistent with the U.S. Model, the proposed treaty contains special rules for dividends paid by U.S. regulated investment companies and real estate investment trusts to prevent the use of structures designed to inappropriately avoid U.S. tax.

The proposed treaty provides a limit of 4 percent on source-country withholding taxes on cross-border interest payments to banks, insurance companies and certain other financial enterprises. For the first five years following entry into force, the proposed treaty provides a limit of 15 percent on all other cross-border interest payments. After the initial five-year period, the 15-percent limit is reduced to 10 percent for all other cross-border interest payments. In addition, consistent with the U.S. Model, source-country tax may be imposed on certain contingent interest and payments from a U.S. real estate mortgage investment conduit. The proposed treaty also permits the United States to impose its branch-level interest tax according to the applicable withholding rate reductions for cross-border interest payments.

The proposed treaty provides a limit of 2 percent on source-country withholding taxes on cross-border royalty payments that constitute a rental payment for the use of industrial, commercial or scientific equipment, and a limit of 10 percent on all other cross-border royalty payments.

The taxation of capital gains under the proposed treaty generally follows the format of the U.S. Model, with some departures in recognition of unique aspects of Chile's domestic tax system. Similar to the U.S. Model, gains derived from the sale of real property and real property interests may be taxed by the country in which the property is located. Likewise, gains from the sale of personal property forming part of a permanent establishment situated in a country may be taxed in that country. Gains from the alienation of shares or other rights or interests in a company may either be taxed at a maximum rate of 16 percent by the country in which the company is a resident, or in certain circumstances in accordance with that country's domestic law. However, the proposed treaty recognizes a unique aspect of Chile's domestic law and provides that these gains shall be taxable only in the country of residence of the seller if Chile makes certain modifications to its corporate tax system in the future. Certain other gains from the alienation of shares of a company are taxable only in the country of residence of the seller, such as gains derived by a pension fund. Furthermore, gains from the alienation of ships, boats, aircraft and containers used in international traffic, as well as gains from the alienation of any property not specifically addressed by the proposed treaty's article on capital gains, are taxable only in the country of residence of the seller.

The proposed treaty permits source-country taxation of business profits only if the business profits are attributable to a permanent establishment located in that country. The proposed treaty generally defines a "permanent establishment" in a way consistent with the U.S. Model. One Model departure that is also found in a number of other U.S. tax treaties with developing countries, deems an enterprise to have a permanent establishment in a country if the enterprise has performed services in that country for at least 183 days in a 12-month period.

The proposed treaty preserves the U.S. right to impose its branch profits tax on U.S. branches of Chilean corporations. The proposed treaty also accommodates a provision of U.S. domestic law providing that income earned during the life of the permanent establishment, but deferred and not received until after the permanent establishment no longer exists, is still attributed to the permanent establishment.

The proposed treaty provides that an individual resident in one country and performing services in the other country will become taxable in the other country only if the individual has a fixed place of business (a so-called "fixed base"). The proposed treaty generally defines "fixed base" in a way consistent with the U.S. Model, with a departure also found in a number of U.S. tax treaties with developing countries which deems an individual to have a fixed base if he has performed services in that country for at least 183 days in the taxable year concerned.

The rules for the taxation of income from employment under the proposed treaty are similar to those under the U.S. Model. The general rule is that employment income may be taxed in the country where the employment is exercised unless three conditions constituting a safe harbor are satisfied.

The proposed treaty permits both the residence country and source country to tax pension payments, although the source country's taxation right is limited to 15 percent of the gross amount of the pension. Consistent with current U.S. tax treaty policy, the proposed treaty permits the deductibility of certain cross-border contributions to pension plans. Also consistent with current U.S. tax treaty policy, the proposed treaty provides for exclusive source-country taxation of social security payments.

The proposed treaty contains a comprehensive "limitation on benefits" article designed to address "treaty shopping," which is the inappropriate use of a tax treaty by residents of a third country. The limitation on benefits article is consistent with current U.S. tax treaty policy, although it contains a special rule for so-called "headquarters companies" that is also found in a number of other U.S. tax treaties.

The proposed treaty incorporates rules that provide that a former citizen or long-term resident of the United States may, for the period of 10 years following the loss of such status, be taxed in accordance with the laws of the United States. The proposed treaty also coordinates the U.S. and Chilean tax rules to address the "mark-to-market" provisions enacted by the United States in 2007, which apply to individuals who relinquish U.S. citizenship or terminate long-term residency.

Consistent with the OECD and U.S. Models, the proposed treaty provides for the exchange between the competent authorities of each country of information that is foreseeably relevant to carrying out the provisions of the proposed treaty or enforcing the domestic tax laws of either country. The proposed treaty allows the United States to obtain information from Chile, including from Chilean financial institutions, regardless of whether Chile needs the information for its own tax purposes.

The proposed treaty will enter into force when the United States and Chile have notified each other that they have completed all of the necessary procedures required for entry into force. With respect to taxes withheld at source, the treaty will have effect for amounts paid or credited on or after the first day of the second month following the date of entry into force. With respect to other taxes, the treaty will have effect for taxable years beginning on or after the first day of January next following the date of entry into force.

Hungary

The proposed tax treaty and related agreement, which will be effected by exchange of notes with Hungary, were negotiated to bring tax treaty relations based on the existing tax treaty into closer conformity with current U.S. tax treaty policy. Entering into a new agreement has been a top tax treaty priority for the Treasury Department because the existing tax treaty with Hungary, signed in 1979, does not contain treaty shopping protections and, as a result, has been used inappropriately by third-country investors in recent years.

The proposed treaty contains a comprehensive "limitation on benefits" article designed to address treaty shopping. Similar to the provision included in all recent U.S. tax treaties with countries that are members of the European Union, the new limitation on benefits article includes a provision granting so-called "derivative benefits". The new limitation on benefits article also contains a special rule for so-called "headquarters companies" that is also found in a number of other U.S. tax treaties.

The proposed treaty incorporates updated rules providing that a former citizen or long-term resident of the United States may, for the period of ten years following the loss of such status, be taxed in accordance with the laws of the United States. The proposed treaty also coordinates the U.S. and Hungarian tax rules to address the "mark-to-market" provisions the United States enacted in 2007, which apply to individuals who relinquish U.S. citizenship or terminate long-term residency.

The withholding rates on investment income in the proposed treaty are the same as or lower than those in the current treaty. The proposed treaty provides for reduced source-country taxation of dividends distributed by a company resident in one country to a resident of the other country. The proposed treaty generally allows for taxation at source of five percent on direct dividends (i.e., where a 10-percent ownership threshold is met) and 15 percent on all other dividends. Additionally, the proposed treaty provides for an exemption from withholding tax on certain cross-border dividend payments to pension funds.

The proposed treaty updates the treatment of dividends paid by U.S. Regulated Investment Companies and Real Estate Investment Trusts to prevent the use of structures designed to inappropriately avoid U.S. tax.

Consistent with the existing treaty, the proposed treaty generally eliminates source-country withholding taxes on cross-border interest and royalty payments. However, consistent with current U.S. tax treaty policy, source-country tax may be imposed on certain contingent interest and payments from a U.S. real estate mortgage investment conduit.

The taxation of capital gains under the proposed treaty generally follows the format of the U.S. Model. Gains derived from the sale of real property and real property interests may be taxed by the State in which the property is located. Likewise, gains from the sale of personal property forming part of a permanent establishment situated in a country may be taxed in that country. All other gains, including gains from the alienation of ships, boats, aircraft and containers used in international traffic, as well as gains from the sale of stock in a corporation, are taxable only in the country of residence of the seller.

The proposed treaty, like several recent U.S. tax treaties, provides that the OECD Transfer Pricing Guidelines apply by analogy in determining the amount of business profits of a resident of the other country. The source country's right to tax such profits is generally limited to cases in which the profits are attributable to a permanent establishment located in that country. The proposed treaty preserves the U.S. right to impose its branch profits tax on U.S. branches of Hungarian corporations. The proposed treaty also accommodates a provision of U.S. domestic law providing that income earned during the life of the permanent establishment, but deferred and not received until after the permanent establishment no longer exists, is still attributed to the permanent establishment.

The proposed treaty would change the rules currently applied under the existing treaty regarding the taxation of independent personal services. Under the proposed treaty, an enterprise performing services in the other country will become taxable in the other country only if the enterprise has a fixed place of business in that country.

The rules for the taxation of income from employment under the proposed treaty are similar to those under the U.S. Model. The general rule is that employment income may be taxed in the country where the employment is exercised unless three conditions constituting a safe harbor are satisfied.

The proposed treaty preserves the current treaty's rules that allow for exclusive residence-country taxation of pensions, and, consistent with current U.S. tax treaty policy, provides for exclusive source-country taxation of social security payments.

Consistent with the OECD and U.S. Models, the proposed treaty provides for the exchange between the tax authorities of each country of information relevant to carrying out the provisions of the proposed treaty or the domestic tax laws of either country. The proposed treaty allows the United States to obtain information (including from financial institutions) from Hungary whether or not Hungary needs the information for its own tax purposes.

The proposed treaty would enter into force on the date of the exchange of instruments of ratification. With respect to taxes withheld at source, the treaty will have effect for amounts paid or credited on or after the first day of the second month following the date of entry into force. With respect to other taxes, the treaty will have effect for taxable years beginning on or after the first day of January next following the date of entry into force. The existing treaty will, with respect to any tax, cease to have effect as of the date on which the proposed treaty has effect with respect to such tax.

Luxembourg

The proposed protocol to amend the existing tax treaty with Luxembourg and the related agreement effected by exchange of notes were negotiated to bring the existing Convention, signed in 1996, into closer conformity with current U.S. tax treaty policy regarding exchange of information.

The proposed protocol replaces the existing treaty's information exchange provisions with updated rules that are consistent with current U.S. tax treaty practice and the current international standards for exchange of information. The proposed protocol allows the tax authorities of each country to exchange information foreseeably relevant to carrying out the provisions of the agreement or the domestic tax laws of either country. Among other things, the proposed protocol would allow the United States to obtain information from Luxembourg whether or not Luxembourg needs the information for its own tax purposes. In addition, the proposed protocol provides that requests for information cannot be declined solely because the information is held by a bank or other financial institution.

The proposed related agreement effected by exchange of notes sets forth agreed understandings between the parties regarding the updated provisions on tax information exchange. The agreed understandings include obligations on the United States and Luxembourg to ensure that their respective competent authorities have the authority to obtain and provide, upon request, information held by banks and other financial institutions and information regarding ownership of certain entities. The agreed understandings also provide that information shall be exchanged without regard to whether the conduct being investigated would be a crime under the laws of the requested country.

The proposed protocol would enter into force once both the United States and Luxembourg have notified each other that their respective applicable procedures for ratification have been satisfied. It would have effect with respect to requests made on or after the date of entry into force with regard to tax years beginning on or after January 1, 2009. The related agreement effected by exchange of notes would enter into force on the date of entry into force of the proposed protocol and would become an integral part of the proposed protocol on that date.

Switzerland

The proposed protocol to amend the existing tax treaty with Switzerland and related agreement effected by exchange of notes were negotiated to bring the existing treaty, signed in 1996, into closer conformity with current U.S. tax treaty policy regarding exchange of information. There are, as with all bilateral tax conventions, some variations from these norms. In the proposed protocol, these minor differences reflect particular aspects of Swiss law and treaty policy, and they generally follow the OECD standard for exchange of information.

The proposed protocol replaces the existing treaty's information exchange provisions with updated rules that are consistent with current U.S. tax treaty practice and the current international standards for exchange of information. The proposed protocol allows the tax authorities of each country to exchange information that may be relevant to carrying out the provisions of the agreement or the domestic tax laws of either country, including information that would otherwise be protected by the bank secrecy laws of either country. The proposed protocol would allow the United States to obtain information from Switzerland whether or not Switzerland needs the information for its own tax purposes, and provides that requests for information cannot be declined solely because the information is held by a bank or other financial institution.

The proposed protocol amends a paragraph of the existing protocol to the existing treaty by incorporating procedural rules to govern requests for information and an agreement between the United States and Switzerland that such procedural rules are to be interpreted in order not to frustrate effective exchange of information.

The proposed protocol and related agreement effected by exchange of notes update the provisions of the existing treaty with respect to the mutual agreement procedure by incorporating mandatory arbitration of certain cases that the competent authorities of the United States and Switzerland have been unable to resolve after a reasonable period of time.

Finally, the proposed protocol updates the provisions of the existing treaty to provide that individual retirement accounts are eligible for the benefits afforded a pension under the existing treaty.

The proposed protocol would enter into force when the United States and Switzerland exchange instruments of ratification. The proposed protocol would have effect, with respect to taxes withheld at source, for amounts paid or credited on or after the first day of January of the year following entry into force. With respect to information exchange, the proposed protocol would have effect with respect to requests for bank information that relate to any date beginning on or after the date the proposed protocol is signed. With respect to all other cases, the proposed protocol would have effect with respect to requests for information that relates to taxable periods beginning on or after the first day of January next following the date of signature. The mandatory arbitration provision would have effect with respect both to cases that are under consideration by the competent authorities as of the date on which the proposed protocol enters into force and to cases that come under consideration after that date.

Protocol to the Multilateral Convention

On January 25, 1988, the OECD and the Council of Europe jointly opened for signature the Multilateral Convention, which the United States signed in 1989 and entered into force for the United States in 1995. The proposed protocol to the Multilateral Convention was negotiated to bring the Multilateral Convention into conformity with current international standards regarding exchange of information for tax purposes.

Although the Multilateral Convention contains broad provisions for the exchange of information, it pre-dates the current internationally agreed standards on exchange of information. Thus, the obligations contained in the Multilateral Convention are subject to certain domestic law limitations that could impede full exchange of information. In particular, the Multilateral Convention does not require the exchange of bank information on request, nor does it override domestic tax interest requirements. In contrast, the current internationally agreed standards on transparency and exchange of information provide for full exchange of information upon request in all tax matters without regard to a domestic tax interest requirement or bank secrecy laws. The proposed protocol amends the Multilateral Convention in order to bring it into conformity with these internationally agreed standards, which are also reflected in the OECD's Model Tax Convention on Income and Capital and the U.S. Model tax treaty. In addition, the proposed protocol brings the confidentiality rules of the Multilateral Convention regarding exchanged information and the limitations regarding the use of such information into conformity with the OECD and U.S. Models.

The Multilateral Convention specifies information the applicant country is to provide the requested country when making a request. In some situations, the name of the person under examination is not known to the applicant country, but there is other information sufficient to identify the person. The proposed protocol amends the Multilateral Convention by providing that a request for assistance is adequate even if the name of the person(s) under examination is not known, provided that the request contains sufficient information to identify the person or ascertainable group or category of persons.

The original Multilateral Convention was open for signature and ratification only by countries which are members of the Council of Europe, the OECD, or both. The proposed protocol amends the Multilateral Convention by allowing any country to become a party thereto. However, countries which are not members of the OECD or of the Council of Europe may only become a party to the amended Convention subject to unanimous consent of the parties to the amended Convention.

The Multilateral Convention as amended by the proposed protocol entered into force on June 1, 2011 for countries that signed and ratified it prior to that date. For countries that ratify subsequent to that date, the Multilateral Convention as amended by the proposed protocol will enter into force on the first day of the month following the expiration of a period of three months after the date of deposit of the instrument of ratification with one of the Depositaries.

Any Member State of the Council of Europe or of the OECD that is not yet a party to the Multilateral Convention will become a party to the Multilateral Convention as amended by the proposed protocol upon ratification of the Convention as amended by the proposed protocol by that Member State, unless it explicitly expresses the will to adhere exclusively to the un-amended Convention. Any country that is not a member of the OECD or the Council of Europe that subsequently becomes a party to the Convention as amended by the proposed protocol shall be a party to the Convention as amended by the proposed protocol.

The amendments shall have effect for administrative assistance related to taxable periods beginning on or after January 1 of the year following the year in which the Convention as amended by the proposed protocol, entered into force in respect of a party. Where there is no taxable period, the amendments shall have effect for administrative assistance related to charges to tax arising on or after January 1 of the year following the year in which the Convention as amended by the proposed protocol entered into force in respect of a party. Any two or more parties may mutually agree that the Convention as amended by the proposed protocol may have effect for administrative assistance related to earlier taxable periods or charges to tax. However, for criminal tax matters, the proposed protocol provides that the Convention as amended by the proposed protocol shall have effect for any earlier taxable period or charge to tax from the date of entry into force in respect of a party. A party may nevertheless take a reservation according to which the provisions of the Convention as amended by the proposed protocol would have effect for administrative assistance related to criminal tax matters, only as related to taxable periods beginning from the third year prior to the year in which the Convention as amended by the proposed protocol entered into force in respect of that party. The Administration is not recommending that the United States take such a reservation [because?...].

<u>Treaty Program Priorities</u>

In addition to our work described above to expand the U.S. tax treaty network, the Treasury Department also maintains an active negotiating calendar aimed at modernizing existing tax treaties with many of our key trading partners. In this regard, our recent efforts have borne much fruit. In 2013, we concluded protocols with Spain and Japan that make extensive changes to our bilateral tax treaties with those countries. Revising the Spain treaty has been a top priority of U.S. businesses, because the existing treaty does not reflect the current tax treaty practices of either Spain or the United States. The new Japan protocol makes several key amendments to the existing tax treaty, including an exemption from source country withholding of all payments of interest, mandatory binding arbitration provisions, and rules that will allow the United States to request assistance from the Japanese revenue authorities in the collection of U.S. taxes.

Another key continuing priority for the Treasury Department is updating the few remaining U.S. tax treaties that provide for significant withholding tax reductions but do not include the limitation on benefits provisions needed to protect against treaty shopping. I am pleased to report that in this regard we have made significant progress. In addition to the proposed tax treaty with Hungary, we have also concluded negotiations of new tax treaties with Poland, Norway and Romania, all of which contain comprehensive limitation on benefits provisions. We signed the new treaty with Poland on February 15, 2013, and we hope to transmit it to the Senate for its advice and consent soon. We are preparing the new Norway and Romania treaties for signature in the near future.

Concluding agreements that provide for the full exchange of information, including information held by banks and other financial institutions, is another key priority of the Treasury Department. In this regard, we are in active negotiations with Austria to make a number of key amendments to the existing bilateral tax treaty to including modern provisions for full exchange of information.

Conclusion

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

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