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2010 NFTC Tax Treaty Survey

The survey continues to be an important tool for NFTC members to communicate their tax treaty wish list and issues to the U.S. Treasury and the IRS. An overview of the survey responses follows.

Country Priorities

While there was some change in the ranking of the most significant countries to NFTC member companies who responded to the survey ("respondents"), two countries emerged as the top priorities for the most number of respondents, and the countries in the top tier shifted. As has happened in the past, the countries that rank in the top two tiers (those that were selected by the most respondents) were clustered in groups of four or five; thereafter, a significant drop in votes per country occurs.

- The country that was once again identified as the most important to respondents with 80% of the vote (up from 72% last year) was Brazil--permanent establishment, and residence were the greatest concerns, followed very closely by interest, royalty and dividend withholding.

- The country that received the second highest number with 76% of the vote was Singapore, which moved up significantly from 2009 on the priority list. Permanent establishment, business profits, interest, dividends and royalty withholding were uniformly important. There was also a great deal of concern about the MAP process.

The countries that were identified as the next most significant to respondents with 40-68% of the votes (these countries were also most frequently listed as the first or second most important country by respondents) are: India, China, Canada, Argentina and Mexico. Canada has risen in importance this year due to treaty implementation concerns. India has fallen a bit this year (68%) and China continues to be of great concern to a significant number of respondents. Both Mexico and Argentina have moved up in significance to respondents. The negotiation items that were listed as most significant in each country are:

- India: permanent establishment was by far the biggest concern, followed by business profits, gains, interest, royalties and the MAP process;

- China: permanent establishment, business profits and reducing withholding rates on interest, royalties, and dividends were uniformly important;

- Canada: residence, permanent establishment, dividends and the MAP process were all of concern;

- Argentina: reducing withholding rates on interest and dividends were all significant, followed closely by permanent establishment;

- Mexico: gains, residence, interest withholding and royalties were important, followed by permanent establishment.

The countries that were included in the second tier (with 20-36% of the votes) were S. Korea, Columbia, Taiwan, Switzerland, Japan, Angola, Russia, Saudi Arabia and Vietnam. The priority of the countries in the second tier shifted, as Canada has become more of a priority for treaty implementation issues and moved up on the overall priority list. The items that were selected as most important for these countries are:

- South Korea: permanent establishment, business profits and royalties were the most important, closely followed by interest and dividends;

- Columbia: interest, royalty and dividend withholding and the MAP process;

- Taiwan: permanent establishment, gains, business profits, royalties and dividends were uniformly important;

- Switzerland: dividends and the MAP process were important;

- Japan: Residence, interest, and the MAP process were important;

- Angola: permanent establishment, interest, business profits and gains and the MAP process were all important;

- Russia: business profits, permanent establishment, royalties and dividends and the MAP proces;

- Saudi Arabia: Saudi Arabia: permanent establishment, interest and royalties, and the MAP process;

- Vietnam: permanent establishment, business profits, interest, royalties and the MAP process were important.

The countries that comprise the third tier garnered significantly fewer votes. Receiving between 12-16% of the votes were: Malaysia, Thailand, Australia, Israel, Turkey and Venezuela. The items that were selected as the most important for these countries are:

- Malaysia: residence, business profits, permanent establishment, interest royalties and the MAP process;

- Thailand: residence, permanent establishment, interest, dividends, and the MAP process were all uniformly important;

- Australia: permanent establishment followed by withholding on interest and dividends;

- Israel: residence, permanent establishment, business profits, royalties and the MAP process;

- Turkey: permanent establishment, business profits, royalty, dividends and the mutual agreement process;
- Venezuela: permanent establishment.

The remaining countries received only one to three two votes each.

<u>Question Responses</u>

Question #1 asked respondents to expand upon any tax treaty negotiation issues that were noted in the selection of countries and items.

- The most frequently cited problem was the permanent establishment interpretations in India. India is taking very aggressive positions on P.E. Respondents requested that the tax treaty with India be renegotiated to clarify what constitutes a permanent establishment.

- Respondents requested the enhancement of the U.S. tax treaty network to countries in which multinational corporations have significant business activities: Singapore, Brazil, and China were mentioned most frequently. Respondents cited business profits, royalties and dividends as priority areas with Singapore. Transfer pricing was cited as a problem in Brazil. The Chinese withholding rate was seen as placing an additional burden on companies operating in China.

- Respondents also reiterated the importance of eliminating withholding taxes on interest, royalties and dividends. Specific countries were cited as having high withholding rates, including Mexico and Turkey. The current U.S. Turkey treaty reduced dividend withholding to only 15%, which is the same as the Turkish domestic law rate, so the current treaty provides no benefit. Turkey has recently signed treaties where they have agreed to lower withholding rates (5%) . Respondents would like to see the dividend lowered in the U.S.-Turkey treaty. Mexico expanded its definition of other income subject to withholding to include a variety of payments previously treated as business profits. Mexico also changed its characterization of payments for software to expand the types of payments subject to withholding tax.

- Problems were encountered in permanent establishment interpretations in China, Kuwait, Mexico, Malaysia and Angola. Kuwait is taking particularly aggressive positions on permanent establishment.

- The Middle East and sub-Saharan Africa also were cited as areas where tax treaties could reduce the potential for permanent establishment abuse. Respondents also recommended doing regional treaties, based on a new regional "model" tax treaty, with some of these areas. After a regional treaty was in place, the U.S. could adopt a more robust treaty with specific countries.

- Respondents also recommended updating some of the oldest U.S. treaties, e.g. Philippines and Egypt, as part of this process.

- Binding arbitration and more efficient mutual agreement procedures were also referred to in several responses (to this question and question #2); respondents noted that significant delays were encountered in resolving examinations and that settlements were often held hostage unless taxpayers waived access to mutual agreement procedures. Many respondents would like to see binding arbitration provisions added to all future treaties. A mandatory arbitration provision with the U.K. was requested.

- Respondents requested a zero withholding rate with Japan. Respondents also had issues with the residence clause of the current treaty, specifically in substantiating the tax treatment of pass-through entities that are eligible for treaty benefits. Respondents requested that the L.O.B provision for withholding tax be changed to permit a taxpayer to satisfy the treaty conditions in one year, instead of the three preceding tax years included in the treaty.

Question #2 focused on tax treaty implementation issues, asking respondents to provide details about examinations, settlement problems, and procedural issues encountered in obtaining tax treaty benefits.

- Onerous procedures encountered to receive reduced tax treaty withholding rates were cited, particularly in Italy, Singapore, Portugal, China and the U.K.

- The expansion by certain countries of what constitutes a permanent establishment and the attribution of profits to that permanent establishment (sometime attributable to misinterpretation by tax authorities) is another issue of significant concern to respondents.

- Respondents requested that countries, such as Russia, be encouraged to adhere to their tax treaty clauses on the arms-length standard and permanent establishments, and that these countries do not use indirect taxes or other measures to override the treaty content.

- Respondents requested that the U.S. view be promoted that tax treaties are not purely for the avoidance of double taxation, but have a wider and more important goal, e.g. the bilateral agreement to the allocation of taxing rights, establish minimum thresholds before taxation rights accrue, facilitate cross border flows with minimal withholding taxes and establish procedures to resolve cross border disputes.

- The inability of the MAP and Competent Authority to resolve issues of double taxation was cited frequently with reference to India, Mexico, and Japan. Respondents cited numerous problems with India, both in its expansive view of what constitutes a permanent establishment, and how the MAP cases are processed. There is also concern that the proposed new Direct Tax Code could possibly override the tax treaty.

- The slowness of the MAP process with Canada has been problematic for many respondents. The process for obtaining an APA has also been very slow.