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CONTENTS

Page

Barthold, Thomas A., acting chief of staff, Joint Committee on Taxation, U.S. Congress, Washington, DC 16
Prepared statement 18
Boland, Lois E., Director of the Office on International Relations, U.S. Patent and Trademark Office, Department of Commerce, Washington, DC 25
Prepared statement 26
Response to question submitted by Senator Joseph R. Biden, Jr., concerning ABA letter 54
Responses to questions submitted by Senator Joseph R. Biden, Jr. 56
Harrington, John, International Tax Counsel, Office of the International Tax Counsel, Department of the Treasury, Washington, DC 4
Prepared statement 6
Responses to questions submitted by Senator Joseph R. Biden, Jr. 59
Lucchesi, Janice, chairwoman, Organization for International Investment, Washington, DC 43
Prepared statement 44
Lugar, Hon. Richard G., U.S. Senator from Indiana, prepared statement 3
Menendez, Hon. Robert, U.S. Senator from New Jersey, opening statement 1
Reinsch, Hon. William A., president, National Foreign Trade Council, Washington, DC 38
Prepared statement 40
Scholz, Wesley, Director of the Office of Investment Affairs, Department of State, Washington, DC 28
Prepared statement 30

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

American Intellectual Property Law Association (AIPLA), Arlington, VA, letter to committee 50
Drewsen, Alan C., executive director, International Trademark Association, New York, NY, prepared statement 48
Krupka, Pamela Banner, chair, Section of Intellectual Property Law, American Bar Association, Chicago, IL, letter to committee 53

TREATIES

TUESDAY, JULY 17, 2007

U.S. SENATE,
COMMITTEE ON FOREIGN RELATIONS,
Washington, DC.

[Treaty Doc. 109–18: Protocol Amending the Convention Between the United States and Finland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income and on Capital; Treaty Doc. 109–19: Protocol Amending the Convention Between the United States and Denmark for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income; Treaty Doc. 109–20: Protocol Amending the Convention Between the United States and Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income and Capital and to Certain Other Taxes; Treaty Doc. 110–3: Convention Between the United States and Belgium for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income and Accompanying Protocol; Treaty Doc. 109–12: Patent Law Treaty and Regulations Under the Patent Law Treaty; Treaty Doc. 109–21: The Geneva Act of the Hague Agreement Concerning the International Registration of Industrial Designs; Treaty Doc. 110–2: The Singapore Treaty on the Law of Trademarks; and Treaty Doc. 109–8: Protocol to the 1951 Treaty of Friendship, Commerce, and Navigation Between the United States and Denmark.]

The committee met, pursuant to notice, at 2:30 p.m., in room SD–419, Dirksen Senate Office Building, Hon. Robert Menendez, presiding.

Present: Senators Menendez and Lugar.

OPENING STATEMENT OF HON. ROBERT MENENDEZ, U.S. SENATOR FROM NEW JERSEY

Senator MENENDEZ. This hearing will come to order.

Let me welcome our witnesses and distinguished guests to the Foreign Relations Committee's hearing. I appreciate the work of the ranking member of the committee, and I am delighted to—delighted—to hold this hearing on three protocols amending existing tax treaties with Finland, Denmark, and Germany, a new tax treaty with Belgium, three intellectual property treaties and one separate protocol with Denmark.

As you know, we have a very ambitious agenda, with full witness panels, so I'll keep this statement brief.

I will say for the purposes of proceeding, there is a vote to take place at 2:45. It is the Chair's intention to start the testimony of witnesses, to go as close as possible into that vote, and then we may adjourn for approximately 20 minutes, 25 minutes or so, while that vote is finishing and certain matters take place on the floor.

The United States currently has 58 bilateral income tax treaties that cover 66 countries. This network covers the vast majority of foreign trade and investment of U.S. companies. These treaties help establish a framework that allows international trade and investment to flourish, and, therefore, help bolster economic relationships between the United States and countries that are already close trade and investment partners.

These bilateral tax treaties are the primary means for eliminating unnecessary barriers to cross-border trade and investment. They accomplish this through providing greater certainty to taxpayers, dividing taxing rights between the two jurisdictions so the taxpayer is not subject to double taxation, reducing the risks of excessive taxation, and by ensuring that taxpayers will not be subject to discriminatory taxation in the foreign jurisdiction.

As we live in an increasingly globalized world, it is crucial to take steps to harmonize the tax systems of two countries which will benefit from these treaties. But these treaties will benefit not only U.S. enterprises, but help the U.S. economy grow and increase U.S. employment. Ultimately, I believe these treaties will contribute to strengthening the rule of law and improving the quality of life.

With reference to these tax treaties, we'll first look at the protocols amending provisions of existing income tax treaties with Finland, Denmark, and Germany. We have a strong alliance with these nations, and encourage and engage in significant cross-border activity.

In 2005, Finland and Denmark combined to import 4.2 billion dollars' worth of goods from the United States, and exported a combined 9.4 billion dollars' worth of goods to the United States. In 2006, Germany, alone, imported $34.2 billion in goods and exported 8.48 billion dollars' worth of goods to the United States. These new protocols will stimulate even more growth as they work to avoid double taxation and prevent fiscal evasion with respect to taxes.

Our next agreement is a new tax treaty with Belgium. The value of trade between the United States and Belgium is large, with the United States exporting $18.7 billion of goods and importing $13 billion in goods in 2005. This treaty will also help stimulate more economic growth between our two nations.

We also have before us three specific intellectual property treaties, a patent law treaty, the Geneva Act of the Hague Agreement, concerning the international registration of industrial designs, and the Singapore treaty on the law of trademarks. These three treaties are multilateral instruments that would harmonize and improve the administration of international intellectual property rights. Part of this would be to achieve by—would be achieved by reducing some of the bureaucratic obstacles by introducing innovative measures such as electronic filing.

However, it has been frustrating that it took so long for the implementing legislation to come out of the U.S. Patent and Trade Office for these intellectual property treaties, and I want to be

clear that I expect the Senate and Judiciary Committee to have a chance to carefully review it before voting on the treaty in committee.

And, finally, we will look at the protocol to the Treaty of Friendship, Commerce, and Navigation with Denmark. The protocol is very short. Its entire purpose is to provide a legal basis for issuing treaty investor—E–2—visas to Danish investors who wish to enter the United States on a reciprocal basis.

We are joined today by a distinguished panel of witnesses who will help us evaluate the treaties and protocols before us.

In our first panel, from the Treasury Department, we welcome Mr. John Harrington, the Acting International Tax Counsel; also, Mr. Tom Barthold, the chief of staff of the Joint Committee on Taxation; Mr. Lois Boland, the Director of the Office of International Relations at the United States Patent and Trademark Office; and Mr. Wesley Scholz, Director of the Office of Investment Affairs for the Department of State.

We will also have a second panel. I'll introduce them at that time. The committee looks forward to the insight and analysis of all of our witnesses.

And, finally, let me thank Senator Biden's staff, especially Avril Haines, who has helped us out tremendously in preparing for this hearing.

With that, let me recognize the ranking member of the full committee for any comments he wishes to make.

Senator Lugar.

Senator LUGAR. Thank you very much, Mr. Chairman. Thank you for chairing this important hearing.

I'd like to ask that my statement be made a part of the record.

Senator MENENDEZ. Without objection.

Senator LUGAR. I've simply cited the good work of the last two Congresses in approving tax agreements with a number of countries, and other intellectual property agreements. The very strong panel we have today will affirm the value of the treaties that we're going to consider. I'm supportive of these and am grateful we have come to a hearing to discuss opportunities for action.

Thank you, Mr. Chairman.

[The prepared statement of Senator Lugar follows:]

PREPARED STATEMENT OF HON. RICHARD G. LUGAR, U.S. SENATOR FROM INDIANA

I appreciate the opportunity to evaluate the Patent Law Treaty; the Geneva Act on the Registration of Industrial Designs; the Singapore Treaty on Trademarks; protocols amending the existing tax treaties with Germany, Finland, and Denmark; and a tax treaty update with Belgium. All of these agreements seek to improve our commercial relationships with valued trade and investment partners.

During the last two Congresses, this committee and the full Senate approved tax agreements with Mexico, Australia, the United Kingdom, Japan, Sri Lanka, the Netherlands, Barbados, France, Bangladesh, and Sweden. I encourage the administration to continue its successful pursuit of treaties that strengthen the American economy by helping our businesses access foreign markets and by providing incentives for foreign companies to create more jobs in the United States.

As the United States considers how to maintain economic growth, it is important that we eliminate impediments that prevent our companies from fully accessing international markets. These impediments may come in the form of regulatory barriers, taxes, tariffs, or unfair treatment. In the case of taxes, we should work to ensure that companies pay their fair share, while not being unfairly taxed twice on the same revenue. Tax treaties are intended to prevent double taxation so that companies are not inhibited from doing business overseas. As the U.S. moves to keep

the economy growing and to increase U.S. employment, international tax policies that promote foreign direct investment in the United States are critically important.

The intellectual property treaties before us are also important components of our global economic policy. One of the key benefits of safeguarding intellectual property is preserving innovation. Businesses and inventors must have incentives to undertake the investments needed to create new products. Theft of American intellectual property results in competitive disadvantages to U.S. industries and job losses for American workers.

International counterfeiting and piracy have increased dramatically in recent years. In addition to the direct impact on the sales and profits of the subject industries, there is also significant harm and deception to consumers who believe they are purchasing legitimate goods. We should work to enhance standards and improve the protection of patents, industrial designs, and trademarks.

The agreements we are considering are important to commercial relationships, which advance domestic economic growth and employment. But I would emphasize that these agreements also have diplomatic value. Cooperation on the commercial front enhances our ability to work with nations on other matters.

I thank the witnesses for their testimony, and I look forward to expeditious consideration of each of these agreements by the committee and the full Senate.

Senator MENENDEZ. Thank you, Senator Lugar.

With that, let me start with John Harrington. We're asking that all of your statements—all of your full statements be included in the record, and we're asking you to summarize your written testimony, in the interest of time, to about 7 minutes.

So, with that—Mr. Harrington.

STATEMENT OF JOHN HARRINGTON, INTERNATIONAL TAX COUNSEL, OFFICE OF THE INTERNATIONAL TAX COUNSEL, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Mr. HARRINGTON. Thank you, Mr. Chairman.

Mr. Chairman, Ranking Member Lugar, and distinguished members of the committee, I appreciate the opportunity to appear today before you to recommend favorable action on the four tax agreements that are pending before this committee.

I have a written statement that I ask, per your previous statement, be made part of the record.

Senator MENENDEZ. Without objection.

Mr. HARRINGTON. The agreements before the committee today, with Belgium, Denmark, Finland, and Germany, serve to further the goals of our tax treaty network and improve longstanding treaty relationships. All four agreements reduce withholding tax rates for dividends that they meet certain ownership and holding-period requirements. All four agreements include updated limitation-on-benefits provisions and other changes to reflect U.S. law and tax treaty policy. In addition, the proposed new treaty with Belgium and the proposed protocol with Germany provide, in certain circumstances, for arbitration.

Because my written statements and the technical explanations provide detailed explanations of the provisions of the agreements, I would like to describe briefly the more significant features of those agreements.

Finland. The proposed protocol with Finland amends the current convention, which entered into force in 1990. The proposed protocol makes a number of changes to the dividend article of the current convention, including eliminating the source-country withholding tax on dividends meeting certain ownership and holding-period requirements and on dividends to pension funds. It also eliminates

source-country withholding tax on royalties. It updates the limitation-on-benefits article of the current convention, the rules for taxing former citizens and former long-term residents, and the exchange-of-information provisions.

Denmark. The proposed protocol with Denmark closely follows the recent protocol with Sweden and the proposed protocol with Finland with respect to dividends and limitation on benefits. It amends the current convention to update the rules for taxing former citizens and former long-term residents.

Germany. The proposed protocol amends the current convention concluded in 1989. The proposed protocol eliminates the source-country withholding tax on many intercompany dividends. The proposed protocol also eliminates withholding tax on dividends to pension funds and significantly improves the current convention's treatment of pensions. It amends the current convention to update the rules for taxing former citizens and former long-term residents, strengthens the treaty's limitation-on-benefits article, and adopts the U.S. model treaty approach to attribution of profits to a permanent establishment.

The proposed protocol provides for arbitration of certain cases that have not been resolved by the competent authorities within a specified time period, generally 2 years from the commencement of the case. Consistent with the current mutual agreement procedure, the taxpayer can terminate arbitration at any time by withdrawing its request for competent authority assistance. The taxpayer also retains the right to litigate in lieu of accepting the result of arbitration, just as it would be entitled to litigate in lieu of accepting the result of a negotiation under the mutual agreement procedure.

Belgium. The proposed income tax convention and accompanying protocol with Belgium would replace the current convention, which entered into force in 1970. The new proposed treaty would eliminate the withholding tax on interest payments and many intercompany dividends. The new treaty also eliminates withholding tax on dividends to pension funds and updates the current convention's treatment of pensions. It addresses taxation of former citizens and former long-term residents, strengthens limitation on benefits, and adopts the U.S. model treaty approach to attribution of profits to a permanent establishment.

Of particular note is the greatly strengthened information exchange article. The information exchange article of the proposed treaty specifically addresses a number of problems that have prevented effective information exchange under the existing convention. The new provision makes clear that Belgium is obligated to provide the United States with such information, including bank information, as is necessary to carry out the treaty in our domestic law.

Like the proposed protocol with Germany, the proposed treaty provides for arbitration of certain cases before the competent authorities. The arbitration provision and procedures adopted in the proposed treaty follow closely the approach in the proposed protocol with Germany, with the exceptions that, one, the scope of the arbitration process covers all issues within the purview of the competent authorities, and, two, the process must be completed within 6 months.

In both agreements, the mandatory arbitration provision is designed to achieve the benefit of an arbitration provision with the least disruption to the process of competent authority negotiations.

Before closing, I would like to note that we continue to maintain a very active calendar of tax treaty negotiations. A key priority is updating the few remaining U.S. tax treaties that provide for low withholding tax rates, but do not include limitation-on-benefits provisions.

Let me repeat our appreciation for the committee's interest in these agreements and in the U.S. tax treaty network. We are also grateful for the assistance and cooperation of the staffs of your committee and of the Joint Committee on Taxation in the tax treaty process.

I'd also like to recognize the tireless work of the Treasury team—Jesse Eggert, Henry Louie, Gretchen Sierra, David Sotos, and especially Detta Kissel.

We urge the committee and the Senate to take prompt and favorable action on all of these agreements. I'd be happy to answer any questions that you have.

[The prepared statement of Mr. Harrington follows:]

PREPARED STATEMENT OF JOHN HARRINGTON, INTERNATIONAL TAX COUNSEL, OFFICE OF THE INTERNATIONAL TAX COUNSEL, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Mr. Chairman, Ranking Member Lugar, and distinguished members of the committee, I appreciate the opportunity to appear today at this hearing to recommend, on behalf of the administration, favorable action on four tax agreements that are pending before this committee. We appreciate the committee's interest in these agreements and in the U.S. tax treaty network, as demonstrated by the scheduling of this hearing.

This administration is dedicated to eliminating unnecessary barriers to cross-border trade and investment. The primary means for eliminating tax barriers to trade and investment are bilateral tax treaties. Tax treaties eliminate barriers by providing greater certainty to taxpayers regarding their potential liability to tax in the foreign jurisdiction; by allocating taxing rights between the two jurisdictions so that the taxpayer is not subject to double taxation; by reducing the risk of excessive taxation that may arise because of high gross-basis withholding taxes; and by ensuring that taxpayers will not be subject to discriminatory taxation in the foreign jurisdiction. The international network of over 2,500 bilateral tax treaties has established a stable framework that allows international trade and investment to flourish. The success of this framework is evidenced by the fact that countless cross-border transactions, from an individual's investment in a few shares of a foreign company to a multibillion dollar purchase of a foreign operating company, take place each year, with only a relatively few disputes regarding the allocation of tax revenues between governments.

To ensure that our tax treaties cannot be used inappropriately, we continually monitor our existing network of tax treaties to make sure that each treaty continues to serve its intended purposes and is not being exploited for unintended purposes. A tax treaty reflects a balance of benefits that is struck when the treaty is negotiated and that can be affected by future developments. In some cases, changes in law or policy in one or both of the treaty partners may make it possible to increase the benefits provided by the treaty; in these cases, negotiation of a new or revised agreement may be very beneficial. In other cases, developments in one or both countries, or international developments more generally, may require a revisiting of the agreement to prevent exploitation and eliminate unintended and inappropriate consequences; in these cases, it may be necessary to modify or even terminate the agreement. Both in setting our overall negotiation priorities and in negotiating individual agreements, our focus is on ensuring that our tax treaty network fulfills its goals of facilitating cross-border trade and investment and preventing fiscal evasion.

The agreements before the committee today with Belgium, Denmark, Finland, and Germany serve to further the goals of our tax treaty network and improve long-

standing treaty relationships. We urge the committee and the Senate to take prompt and favorable action on all of these agreements.

PURPOSES AND BENEFITS OF TAX TREATIES

Tax treaties set out clear ground rules that govern tax matters relating to trade and investment between the two countries. A tax treaty is intended to mesh the tax systems of the two countries so that there is little potential for dispute regarding the amount of tax that should be paid to each country. The goal is to ensure that taxpayers do not end up caught in the middle between two governments, each of which claims taxing jurisdiction over the same income. A treaty with clear rules addressing the most likely areas of disagreement minimizes the time the two governments (and taxpayers) spend in resolving individual disputes.

One of the primary functions of tax treaties is to provide certainty to taxpayers regarding the threshold question with respect to international taxation: Whether a taxpayer's cross-border activities will subject it to taxation by two or more countries. Tax treaties answer this question by establishing the minimum level of economic activity that must be engaged in 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 the 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 its residents.

Tax treaties protect taxpayers from potential double taxation through the allocation of taxing rights between the two countries. This allocation takes several forms. First, the 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, the treaty assigns the "primary" right to tax 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, the treaty provides rules for determining which country will be treated as the source country for each category of income. Finally, the treaty provides rules limiting the amount of tax that the source country can impose on each category of income and 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.

As a complement to these substantive rules regarding allocation of taxing rights, tax treaties provide a mechanism for dealing with disputes or questions of application that arise after the treaty enters into force. In such cases, designated tax authorities of the two governments—known as the "competent authorities" in tax treaty parlance—are to consult and reach an agreement under which the taxpayer's income is allocated 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. That function has been delegated to the Deputy Commissioner of the Internal Revenue Service, Large and Mid-Size Business (International).

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. domestic 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 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. The taxpayer may be viewed, therefore, as suffering "excessive" taxation. Tax treaties alleviate this burden by setting maximum levels for the withholding tax that the treaty partners 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. Because of the excessive taxation that withholding taxes can represent, the United States seeks to include in tax treaties provisions that substantially reduce or eliminate source-country withholding taxes.

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 nondiscrimination 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. At the same time, tax treaties clarify the manner in which possible discrimination is to be tested in the tax context. Particular rules are needed here, for example, to reflect the fact that foreign persons that are subject to tax in the host country only on certain income may not be in the same position as domestic taxpayers that may be subject to tax in such country on all their income.

In addition to these core provisions, tax treaties include provisions dealing with more specialized situations, such as rules coordinating the pension rules of the tax systems of the two countries or addressing the treatment of Social Security benefits and alimony and child-support payments in the cross-border context. 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.

Tax treaties also include provisions related to tax administration. A key element of U.S. tax treaties is the provision addressing the exchange of information between the tax authorities. Under tax treaties, the competent authority of one country may request from the other competent authority such information as may be relevant for the proper administration of the first country's tax laws; the information provided pursuant to the request is subject to the strict confidentiality protections that apply to taxpayer information. Because access to information from other countries is critically important to the full and fair enforcement of the U.S. tax laws, information exchange is a priority for the United States in its tax treaty program. If a country has bank-secrecy rules that would operate to prevent or seriously inhibit the appropriate exchange of information under a tax treaty, we will not conclude a tax treaty with that country. Indeed, the need for appropriate information exchange provisions is one of the treaty matters that we consider non-negotiable.

TAX TREATY NEGOTIATING PRIORITIES AND PROCESS

The United States has a network of 58 income tax treaties covering 66 countries. This network covers the vast majority of foreign trade and investment of U.S. businesses. In establishing our negotiating priorities, our primary objective is the conclusion of tax treaties or protocols that will provide the greatest economic benefit to the United States and to U.S. taxpayers. We communicate regularly with the U.S. business community, seeking input regarding the areas in which treaty network expansion and improvement efforts should be focused and information regarding practical problems encountered under particular treaties and particular tax regimes.

The primary constraint on the size of our tax treaty network may be the complexity of the negotiations themselves. The various functions performed by tax treaties, and most particularly the need to mesh the particular tax systems of the two treaty partners, make the negotiation process exacting and time-consuming. Accordingly, it frequently will make more sense for the United States to negotiate an update to an existing agreement, rather than to negotiate a new tax treaty.

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

Moreover, a country's fundamental tax policy choices are reflected not only in its tax legislation 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 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 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. In most cases, the process of give-and-take produces a document that is the best tax treaty that is possible with that country. In other cases, we may reach a point where it is clear that it will not be possible to reach an acceptable agreement. In those cases, we simply stop negotiating with the understanding that

negotiations might restart if circumstances change. Each treaty that we present to the Senate represents not only the best deal that we believe we can achieve with the particular country, but also constitutes an agreement that we believe is in the best interests of the United States.

In some situations, the right result may be no tax treaty at all or may be a substantially curtailed form of tax agreement. With some countries a tax treaty may not be appropriate because of the possibility of abuse. With other 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 double taxation of cross-border income, and an agreement that is focused on the exchange of tax information may be the most appropriate agreement. Alternatively, a bifurcated approach may be appropriate in situations where a country has a special preferential tax regime for certain parts of the economy that is different from the tax rules generally applicable to the country's residents. In those cases, the residents benefiting from the preferential regime may not face potential double taxation and so should not be entitled to the reductions in U.S. withholding taxes accorded by a tax treaty, while a full treaty relationship might be useful and appropriate to avoid double taxation in the case of the residents who do not receive the benefit of the preferential regime.

Prospective treaty partners must evidence a clear understanding of what their obligations would be under the treaty, including 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.

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, the benefits would flow only in one direction 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 country's 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. 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 that we can secure for U.S. persons the benefits of reductions in source-country tax on their investments in that country.

CONSIDERATION OF ARBITRATION

Tax treaties cannot facilitate cross-border investment and provide a more stable investment environment unless the agreement is effectively implemented by the tax administrations of the two countries. 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 seeks to resolve the matter with the competent authority of the treaty partner. The competent authorities will 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 will be instances in which the competent authorities will not be able to reach a timely and satisfactory resolution. Moreover, as the number and complexity of cross-border transactions increases, so does 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 resolve disputes promptly, including the possible use of arbitration in the competent authority process.

The first U.S. tax agreement that contemplates arbitration is the current U.S.-Germany income tax treaty, signed in 1989. Tax treaties with several other countries, including Canada, Mexico, and the Netherlands, incorporate authority for establishing voluntary binding arbitration procedures based on the provision in the U.S.-Germany treaty. Although we believe that the presence of these voluntary arbitration provisions may have provided some limited assistance in reaching mutual agreements, it has become clear that the ability to enter into voluntary arbitration does not provide sufficient incentive to resolve problem cases in a timely fashion.

Over the past few years, we have carefully considered and studied mandatory arbitration procedures. 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 process. Based on our review of the U.S. experience with 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.

Two of the agreements before the committee (Germany and Belgium) adopt an expedited approach to mandatory arbitration designed to achieve the benefit of an arbitration provision with the least disruption to the process of competent authority negotiation. Thus, the mandatory arbitration process is formulated as part of the mutual agreement procedure rather than as a separate, extrajudicial procedure.

As in the current mutual agreement procedure, a U.S. taxpayer presents its problem to the competent authority and participates in formulating the position the U.S. competent authority will take in discussions with the treaty partner. Under the new arbitration provisions, if the competent authorities cannot come to resolution within 2 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 can resolve the issue only by choosing the position of one of the competent authorities. That position is adopted as the agreement of the competent authorities and is treated like any other mutual agreement (i.e., one that has been negotiated) under the treaty.

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. If the arbitration provision is successful, difficult issues will be resolved without resort to arbitration. Thus, it is our expectation that these arbitration provisions will be rarely utilized, but that their presence will encourage the competent authorities to take approaches to their negotiations that result in mutually agreeable conclusions.

The arbitration process adopted in the agreements with Germany and Belgium is mandatory and binding with respect to the competent authorities. However, consistent with the negotiation process under the mutual agreement procedure, 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 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.

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 Belgium and Germany once ratified. Although the competent authorities of these countries generally work well with our competent authority, we believe that these proposed arbitration provisions will supplement and reinforce the current competent authority process in those treaties and will facilitate negotiation of arbitration provisions with other countries with which we need to bolster the competent authority process.

In short, the goal is to craft, in a manner acceptable to each appropriate treaty partner, an effective mechanism to facilitate the ordinary process of negotiation under the treaty's mutual agreement procedure.

DISCUSSION OF PROPOSED NEW TREATY AND PROTOCOLS

I now would like to discuss the four agreements that have been transmitted for the Senate's consideration. We have submitted a Technical Explanation of each agreement that contains detailed discussions of the provisions of each treaty or protocol. These Technical Explanations serve as an official guide to each agreement.

Before describing specific aspects of each agreement, I would like to point out one item shared by all four agreements: The elimination of source-country withholding tax on certain intercompany dividends. As we have stated previously to this committee, we believe that the elimination of source-country taxation of dividends should be considered only on a case-by-case basis. It is not the U.S. model position because we do not believe that it is appropriate in every treaty. Consideration of such a provision in a treaty is appropriate only if the treaty contains antitreaty-shopping rules and an information exchange provision that meet the highest standards. In addition to these prerequisites, the overall balance of the treaty must be considered. We believe that these conditions and considerations are met in all four agreements, and that the United States and U.S. taxpayers will benefit significantly from the elimination of the withholding tax in each agreement.

FINLAND

The proposed protocol with Finland was signed in Helsinki on May 31, 2006, and amends the current Convention, which entered into force in 1990. The most significant provisions in this agreement relate to dividends, royalties, antiabuse provisions, and exchange of information. The protocol also makes a number of necessary updates to the current Convention and brings the Convention more in line with recent agreements with other Nordic countries.

The proposed protocol makes a number of changes to the dividend article of the current Convention. As mentioned above, the proposed protocol eliminates the source-country withholding tax on many intercompany dividends. In general, a company receiving a dividend must have a substantial interest in the distributing corporation for a 12-month period and meet special limitation on benefits provisions to qualify for the exemption from withholding tax. The proposed protocol also eliminates the source-country withholding tax on dividends paid to pension funds. This provision is necessary to eliminate the double taxation that occurs when tax is imposed on distributions to pension funds that cannot be credited or used against further tax in the hands of the beneficiaries of the fund. The proposed protocol also updates the dividend article to incorporate policies reflected in the U.S. model provision, such as those regarding real estate investment trusts (REITs).

The proposed protocol makes a significant change to the royalty article of the current Convention. The current Convention allows the source country to withhold on royalty payments with respect to certain types of property to residents of the other treaty partner, but limits the withholding rate to a maximum of 5 percent. The proposed protocol eliminates source-country withholding on royalties payments regardless of the type of intellectual property involved, bringing the Convention in line with the U.S. model treaty.

The proposed protocol makes a number of changes to the limitation on benefits article of the current Convention. It tightens the limitation on benefits rules applicable to publicly traded companies to ensure a closer nexus between the company and its residence country through regional trading or local management and control. The protocol further tightens the limitation on benefits provision by including a so-called "triangular provision" adopted in many U.S. treaties with countries that exempt income earned in third countries. Under the provision, the United States need not allow full treaty benefits to a Finnish enterprise with respect to certain income exempt from Finnish tax and attributable to a permanent establishment in a third state if the income is not subject to a sufficient level of tax in the third state. The proposed protocol also includes a provision adopted in U.S. agreements with many European countries that allows a company resident in one of the contracting states to qualify for treaty benefits in the other state if the company is substantially owned by third-country residents that would themselves qualify for equivalent benefits under their own treaties with the other state.

The proposed protocol includes other antiabuse rules. It extends the provision in the current Convention that preserves the U.S. right to tax certain former citizens, also to cover certain former long-term residents, and updates the provision to reflect changes in U.S. law. The proposed protocol conforms the interest article in the current Convention to the U.S. model treaty by including special contingent interest and real estate mortgage investment conduit (REMIC) exceptions to the elimination of withholding tax on interest payments.

The proposed protocol also includes several other important administrative and technical modifications. Significantly, it updates the exchange of information provisions to specify the obligation to obtain and provide information held by financial institutions, and to otherwise reflect U.S. model standards in this area.

Once ratified by the Senate, the proposed protocol will enter into force upon the exchange of instruments of ratification. For taxes withheld at source, the proposed

protocol will generally have effect within 2 months after entry into force. However, if such instruments are exchanged before December 31, 2007, the countries agreed to eliminate withholding taxes for intercompany dividends and dividends to pension funds for dividends derived on or after January 1, 2007. With respect to other taxes, the protocol will have effect January first of the year following the year in which the protocol enters into force.

DENMARK

The proposed protocol with Denmark was signed in Copenhagen on May 2, 2006. The proposed protocol closely follows the recent protocol with Sweden, which entered into force in 2006, and the proposed protocol with Finland, described above, with respect to dividends and limitation on benefits.

As noted above, the proposed protocol amends the dividend article to eliminate the withholding tax on intercompany dividends when a company meets certain ownership and limitation on benefits requirements. In addition, the proposed protocol conforms to current U.S. tax treaty policy by eliminating withholding tax on dividends to pension funds. The provisions of the current Convention applicable to regulated investment companies (RICs) and REITs are updated to apply reciprocally, should Denmark and the United States agree that certain Danish companies are similar to U.S. RICs and REITs. In addition, the proposed protocol includes other updates to the dividend article, including a definition of "diversified" to clarify the application of the REIT provisions adopted in 1999.

The proposed protocol makes changes to the limitation on benefits provision to tighten the publicly traded test, consistent with the policy reflected in the U.S. model treaty. It also tightens the limitation on benefits provision by adopting a triangular provision similar to the provision adopted in the proposed protocol with Finland and in many other U.S. tax treaties; the provision would deny full U.S. treaty benefits to Danish enterprises with respect to certain income exempt from tax in Denmark. The protocol continues the special rules applicable to Danish taxable nonstock corporations. A Danish taxable nonstock corporation is a vehicle used to prevent takeovers of operating companies through control of voting shares, with public shareholders receiving most rights to dividends of the operating company. Because of the constraints applicable to such corporations, the structure is not likely to be subject to treaty shopping abuses.

The proposed protocol also amends the current Convention to address individuals who have expatriated. The new language better reflects the current statutory language regarding the taxation of former citizens and long-term residents of the United States. The provision now states that the United States may, for the period of 10 years following the loss of such status, tax such individuals in accordance with the laws of the United States.

Following Senate ratification, the proposed protocol will enter into force upon the receipt of the later of the notifications that the requirements for entry into force have been met in each country. It will have effect within 2 months of entry into force for taxes withheld at source. With respect to other taxes, the proposed protocol will have effect January first of the year following the year in which the protocol enters into force.

GERMANY

The proposed protocol was signed in Berlin on June 1, 2006, and amends the current Convention, concluded in 1989. The most significant provisions in this agreement relate to taxation of cross-border dividend payments, coordination of pension rules, and adoption of mandatory arbitration as part of the mutual agreement procedure. The proposed protocol also makes a number of changes to reflect changes in U.S. and German law, and to bring the Convention into closer conformity with current U.S. tax treaty policy.

As mentioned above, the proposed protocol eliminates the source-country withholding tax on many intercompany dividends. The proposed protocol also eliminates withholding tax on cross-border dividend payments to pension funds.

The proposed protocol updates the current Convention's treatment of pensions. It removes barriers to the flow of personal services between the United States and Germany that could otherwise result from discontinuities in the laws of the two countries regarding the deductibility of pension contributions. Like the U.S. model treaty, an individual employed in one country who participates in a pension plan in the other may, subject to certain conditions, be allowed in his country of employment to deduct contributions to his plan in the other country. Because significant changes in German law will phase in over time to allow Germany to tax distributions of retirement income rather than taxing contributions and accretions to pen-

sion funds, the United States has agreed to consult with Germany in the future (but not before January 1, 2013) to provide for limited source-based taxation of certain distributions of retirement income. As discussed above, the proposed protocol provides for mandatory arbitration of certain cases that have not been resolved by the competent authorities within a specified period, generally 2 years from the commencement of the case. This provision is the first of its kind in a U.S. tax treaty. Under the protocol, the arbitration process may be used to reach an agreement with respect to certain issues relating to residence, permanent establishment, business profits, associated enterprises, and royalties. The arbitration board must deliver a determination within 9 months of the appointment of the Chair of the Board. Consistent with the current mutual agreement procedure, the taxpayer can terminate arbitration at any time by withdrawing its request for competent authority assistance. The taxpayer also retains the right to litigate 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 proposed protocol makes a number of changes to the current Convention to reflect legislative changes since 1989 and current treaty policy. For example, the proposed protocol provides that former citizens or long-term residents 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, makes technical changes to the article dealing with the elimination of double taxation, significantly strengthens the treaty's limitation on benefits provisions, and adopts the U.S. model treaty approach to attribution of profits to a permanent establishment.

Once ratified by the Senate, the proposed protocol will enter into force upon the exchange of instruments of ratification. For taxes withheld at source, the proposed protocol will generally have effect January first of the year in which it enters into force. With respect to other taxes, the protocol generally will have effect January first of the year following the year in which the protocol enters into force. Special effective date rules apply to arbitration in the mutual agreement process, taxation of income from government service, and coordination of the treaty's nondiscrimination provisions with those of nontax agreements. The taxpayer may elect to apply the current Convention, as unmodified by the proposed protocol, for the year following these effective dates.

BELGIUM

The proposed income tax Convention and accompanying protocol (the proposed treaty) with Belgium was negotiated to replace the current Convention, concluded in 1970 and amended by protocol in 1987 (the existing Convention). The proposed treaty makes a number of changes to conform to changes in U.S. law and to reflect current U.S. tax treaty policy, particularly with respect to exchange of information. Highlights of the proposed treaty are discussed under appropriate headings below.

a. Taxation of Investment Income

The proposed treaty is similar to the other agreements before the committee in that it eliminates the withholding tax on many intercompany dividends. The proposed treaty eliminates withholding tax on dividends paid by a U.S. company to a Belgian company with respect to a significant (80 percent or more) and long-term (12 month or more) interest, and only if the Belgian company meets special limitation on benefits provisions. Unlike the other agreements, a U.S. company need only own 10 percent or more of a Belgian company to receive such benefits with respect to intercompany dividends. This difference reflects the different tax treaty policy of the countries and Belgian domestic tax initiatives. Consistent with the existing Convention, 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 that do not qualify for the zero rate. The proposed treaty also provides for a withholding rate of zero on cross-border dividend payments to pension funds. The proposed treaty also updates the dividend article to incorporate policies reflected in the U.S. model provision, such as those regarding RICs and REITs.

Agreeing to eliminate withholding tax on dividends was key to achieving our important policy goal of improving exchange of information with Belgium. In the proposed treaty, the United States reserves the right to terminate this exemption if it is determined that Belgium has not complied with its obligations under the new provisions included in article 24 (Mutual Agreement Procedure) and article 25 (Exchange of Information and Administrative Assistance) of the proposed treaty. If the United States terminates the provision eliminating the withholding tax on dividends, then, as discussed below, Belgium's obligation to provide information held by

a bank or other financial institution pursuant to the new exchange of information provision would also terminate.

The proposed treaty generally eliminates source-country withholding taxes on cross-border interest payments. This is a substantial improvement over the existing Convention, which provides for a general withholding tax rate of 15 percent on such payments, with certain exceptions. Consistent with U.S. tax treaty policy, source-country tax may be imposed on certain contingent interest and payments from a U.S. REMIC.

Consistent with the existing Convention, the proposed treaty provides that royalties generally may not be taxed at source.

The taxation of capital gains under the proposed treaty generally follows the format of the U.S. model treaty. Gains derived from the sale of real property and from 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 contracting state may be taxed in that state. All other gains, including gains from the alienation of ships, boats, aircraft, and containers used in international traffic and gains from the sale of stock in a corporation, are taxable only in the state of residence of the seller.

b. Taxation of Business Income

The proposed treaty changes the rules in the existing Convention by adopting the U.S. model approach to attribution of profits to a permanent establishment. The proposed treaty generally defines a "permanent establishment" in a manner consistent with the U.S. model treaty.

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

The proposed treaty updates the existing Convention with respect to international transport. It provides, consistent with the U.S. model treaty, for exclusive residence-country taxation of profits from international transport by ships and aircraft. This reciprocal exemption extends to income from the rental of ships and aircraft on a full basis, as well as income from rentals on a time or voyage basis if the ship or aircraft is operated in international traffic by the lessee or the income is incidental to income from the operation of ships or aircraft in international traffic by the lessor. Income from other rentals of ships or aircraft is treated as business profits under article 7. As such, this class of income is taxable only in the country of residence of the beneficial owner of the income unless the income is attributable to a permanent establishment in the other country, in which case it is taxable in that country on a net basis. In addition, as provided in the U.S. model treaty, only the country of residence may tax profits from the maintenance or rental of containers used in international traffic.

c. Taxation of Personal Services Income

The rules for the taxation of income from the performance of personal services under the proposed treaty are similar to those under the U.S. model treaty and the existing Convention.

d. Arbitration

Like the proposed protocol with Germany, the proposed treaty provides for mandatory arbitration of certain cases before the competent authorities. The arbitration provision and procedures adopted in the proposed treaty follow closely the approach in the proposed protocol with Germany, except that Belgium and the United States agreed that the scope of the arbitration process would cover all issues within the purview of the competent authority and that the process must be completed in 6 months. The agreement with Belgium reflects both countries' recognition of the positive role arbitration can play in facilitating agreement between the competent authorities.

e. Pensions

The proposed treaty also updates the existing Convention's treatment of pensions. The proposed treaty removes barriers to the flow of personal services between the countries that could otherwise result from discontinuities in the laws of the countries regarding the deductibility of pension contributions. The proposed treaty generally allows a deduction in the country where an individual is employed for payments made to a plan resident in the other country, if the structure and legal requirements of such plans in the two countries are similar. Similarly, if a resident of one of the countries participates in a pension plan established in the other coun-

try, the country of residence will not tax the income of the pension plan with respect to that resident until a distribution is made from the pension plan. The pension provision in the proposed treaty recognizes that triangular cases may increasingly arise due to the flows of services within Europe and the North American Free Trade Agreement (NAFTA) countries, and provides for beneficial treatment of contributions and accretions into certain funds in comparable third states. A comparable third state is a member state of the European Union or the European Economic Area, Switzerland, or a party to NAFTA, provided that treaty provisions with that third state provide certain reciprocal benefits and satisfactory information exchange.

f. Anti-Abuse Provisions

The proposed treaty also strengthens the limitation on benefits provision and brings it into closer conformity with current U.S. treaty policy. This updated provision is designed to deny "treaty shoppers" the benefits of the proposed treaty. Like some of U.S. treaties, the proposed treaty also allows treaty benefits to certain companies functioning as headquarters for multinational groups if certain conditions are met.

The proposed treaty preserves the U.S. right to tax individuals who expatriated for tax purposes. The proposed treaty updates this provision to reflect legislative changes since 1987. Accordingly, the proposed treaty provides 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.

g. Exchange of Information

The information exchange provision of the proposed treaty specifically addresses a number of problems that have prevented effective information exchange under the existing Convention. The new provision makes clear that Belgium is obligated to provide the United States with such information as is necessary to carry out the provisions of the proposed treaty and the domestic laws of the parties. Further, information can be obtained and provided by Belgium whether or not Belgium needs the information for its own tax purposes. The Treasury Department is satisfied that under this provision Belgium is able to provide adequate tax information, including bank information, to the United States.

Finally, as discussed above, if the United States terminates the dividend-withholding-exemption provision, then Belgium will no longer be required to provide information held by a bank or other financial institution.

h. Entry Into Force

Following Senate ratification, the proposed treaty will enter into force upon the exchange of instruments of ratification and notification through diplomatic channels. For taxes withheld at source, the proposed treaty will generally have effect within 2 months after entry into force. With respect to other taxes, the proposed treaty will have effect January first of the year following the year in which the proposed treaty enters into force. Special effective date rules apply to the limitation on benefits provision relating to headquarters companies, arbitration in the mutual agreement process and exchange of information. In general, the taxpayer may elect to extend the application of the existing Convention (in its entirety) to the 12-month period following the effective dates of this proposed treaty. However, the election does not affect the effective date of the new exchange of information provisions.

TREATY PROGRAM PRIORITIES

We continue to maintain a very active calendar of tax treaty negotiations. We recently signed treaties with Bulgaria and Iceland. We have substantially completed work with Canada and Norway, and we currently are in ongoing negotiations with Chile and Hungary. We also expect to announce soon the onset of other negotiations.

A key continuing priority is updating the few remaining U.S. tax treaties that provide for low withholding tax rates but do not include the limitation on benefits provisions needed to protect against the possibility of treaty shopping. We also have undertaken exploratory discussions with several countries in Asia and South America that we hope will lead to productive negotiations later in 2007 or 2008.

CONCLUSION

Mr. Chairman and Ranking Member Lugar, let me conclude by thanking you for the opportunity to appear before the committee to discuss the administration's efforts with respect to the four agreements under consideration. We appreciate the committee's continuing interest in the tax treaty program, and 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 staffs of this committee and of the Joint Committee on Taxation in the tax treaty process.

On behalf of the administration, we urge the committee to take prompt and favorable action on the agreements before you today.

Senator MENENDEZ. Thank you, Mr. Harrington. I want to thank you, because you did that in 5 minutes.

Mr. Barthold.

STATEMENT OF THOMAS A. BARTHOLD, ACTING CHIEF OF STAFF, JOINT COMMITTEE ON TAXATION, U.S. CONGRESS, WASHINGTON, DC

Mr. BARTHOLD. Mr. Harrington lays down quite the challenge.

It's my pleasure to present the testimony of the staff of the Joint Committee on Taxation today concerning the proposed income tax treaty with Belgium and the proposed income tax protocols with Denmark, Finland, and Germany.

The Joint Committee staff has prepared detailed pamphlets covering the proposed treaties and protocols which provide descriptions of the treaties and protocols, include comparisons to the current U.S. model income tax convention of November 2006, and make comparison to other recent U.S. tax treaties. They also provide, for your consideration, some discussion of issues that the committee may wish to consider in its deliberations.

I will try to highlight a couple of key features of the proposed treaty and protocols, and certain issues that they may raise.

The Joint Committee staff, over the past couple of Congresses, and your committee, has noted a drift away from the 1996 Treasury model treaty, in terms of treaties that were brought before the Senate. And, in that regard, it's important to note that, in November 2006, the Treasury Department released a new model income tax treaty. As a general matter, the 2006 U.S. model treaty incorporates the key developments in U.S. income tax treaty policy that have been reflected in recent U.S. income tax treaties, and the proposed treaty and protocols before you today are generally consistent with the provisions found in that 2006 model treaty.

Let me highlight a couple of areas from the model treaty.

First of all, limitation on benefits. One area in which the proposed treaty and protocols are generally consistent with the new 2006 model treaty is the inclusion in all four proposed instruments of comprehensive limitation-on-benefits provisions. These provisions reflect significant changes in U.S. treaty policy and are generally intended to make it more difficult for third-country residents to benefit inappropriately from a treaty between the two countries.

The limitation-on-benefits provisions of the proposed treaties and protocols are generally similar to one another. However, there are a couple of significant differences. One that I'd like to note is that the public trading test in the limitation-on-benefits provision in the proposed protocol with Germany may be satisfied only if the principal class of a company's shares is primarily traded on a recognized stock exchange located in the company's country of residence, while the test for the other three countries may be satisfied by trading on a regional exchange. That, no doubt, is an outgrowth of the substantial stock exchange in Frankfurt and much smaller exchanges in the countries of Finland, Denmark, and Belgium.

Another area to note, relative to the U.S. model treaty, and a significant difference between the U.S. model and the proposed treaty and protocols, is the zero rate of withholding tax on certain intercompany dividends provided under all four of the proposed treaties.

Until 2003, no United States income tax treaty provided for complete exemption from dividend withholding; however, recent United States income tax treaties and protocols with Australia, Japan, Mexico, the Netherlands, Sweden, and the United Kingdom all include zero-rate provisions.

The zero-rate provision of the proposed treaty and protocols generally provide a zero rate of withholding tax on certain dividends received by a parent company from a subsidiary that is at least 80-percent owned by the parent. Eligibility for the zero rate is contingent on satisfaction of more stringent limitation-on-benefit requirements than generally apply under the proposed treaty and protocols.

However, the zero-rate provision in the proposed treaty with Belgium includes two unique features that might be worth the committee's note. First, the required ownership threshold for dividends paid by Belgian companies to U.S. companies is 10 percent rather than 80 percent. And, second, the provision allows the United States to terminate that zero-rate provision for dividends paid by U.S. companies if Belgium fails to comply with certain obligations under the exchange-of-information and mutual-agreement provisions. Basically, if, within a 5-to-6-year period, Belgium does not put in place provisions providing for exchange of information, the United States can terminate this treaty benefit.

The model treaty does not include a zero-rate provision. In previous testimony before the committee, the Treasury Department has indicated that zero-rate provisions should be allowed only under treaties that have restrictive limitation-on-benefit rules and provide comprehensive information exchange. The Treasury has also stated that granting a zero rate on a dividend withholding tax should also be based on an evaluation of the overall balance of benefits under the treaty. So, the committee may wish to consider what overall balance considerations might prompt the Treasury Department not to seek a zero-rate provision in a treaty that has limitation-on-benefits and information and exchange provisions meeting the highest standards, such as those found in the new 2006 U.S. model treaty.

The other major point to highlight in two of the agreements before you today, and noted by my friend John Harrington, is the provision in the Belgium Treaty and the proposed protocol with Germany for mandatory and binding arbitration. This provision is not included in the U.S. model. We have seen worldwide movement toward arbitration provisions. The OECD model treaty provides for arbitration provisions. The European Union has provided for arbitration provisions in transfer pricing cases within the European Union. However, the information that would help clarify whether there is a problem with the competent-authority process under the U.S. treaty network, as well as information that would help identify the extent of the problem and its root causes, is not really publicly available. Consequently, if unresolved competent authority proceedings are a problem for the United States, it is difficult to

determine whether mandatory and binding arbitration would solve it.

The committee may wish to assess the basis for the Treasury Department, or taxpayers, to believe that, in fact, that there is a problem with the current resolution of disputes through the competent-authority process. For example, are the problems that are identified pervasive or idiosyncratic to the specific countries or specific tax issues?

Also, there are many potential variations in arbitration methodology. The two that you are considering today follow what's known in the United States as the baseball arbitration model. But the proposed arbitration could take many other forms, such as what's known as the independent-opinion approach, under which the board is presented with facts and arguments and then draws its own conclusion. Another option that could be considered is the provision of taxpayer involvement in the proceedings. Also, some people have noted, in the proposed agreements, that there is an absence of feedback to the competent authorities regarding the rationale for the board's determination.

Arbitration provisions are new to the United States treaty network. I believe it will take time to ascertain whether these procedures are effective or to determine if unexpected problems arise. In the meantime, it would be not unreasonable to expect that the Treasury Department or other trading partners may seek similar provisions in future agreements. So, the committee may wish to better understand how the Treasury Department intends to monitor the competent-authority function, as well as the arbitration developments, and what data might be relevant to helping the committee determine, in fact, if these procedures do improve the efficient case resolution under the competent-authority process.

Sorry for exceeding my time, and I stand willing to answer any questions that the committee might have.

[The prepared statement of Mr. Barthold follows:]

PREPARED STATEMENT OF THOMAS A. BARTHOLD, ACTING CHIEF OF STAFF, JOINT COMMITTEE ON TAXATION, U.S. CONGRESS, WASHINGTON, DC [1]

My name [1] is Thomas A. Barthold. I am acting chief of staff of the Joint Committee on Taxation. It is my pleasure to present the testimony of the staff of the Joint Committee on Taxation today concerning the proposed income tax treaty with Belgium and the proposed income tax protocols with Denmark, Finland, and Germany.

OVERVIEW

As in the past, the Joint Committee staff has prepared pamphlets covering the proposed treaty and protocols. The pamphlets provide detailed descriptions of the proposed treaty and protocols, including comparisons with the United States Model Income Tax Convention of November 15, 2006 ("2006 U.S. model treaty"), which reflects preferred U.S. tax treaty policy, and with other recent U.S. tax treaties.[2] The

[1] This document may be cited as follows: Joint Committee on Taxation, Testimony of the Staff of the Joint Committee on Taxation Before the Senate Committee on Foreign Relations Hearing on the Proposed Tax Treaty with Belgium and the Proposed Tax Protocols with Denmark, Finland, and Germany (JCX-51-07), July 17, 2007. This publication can also be found at www.house.gov/jct.

[2] Joint Committee on Taxation, "Explanation of Proposed Income Tax Treaty Between the United States and Belgium" (JCX–45–07), July 13, 2007; Joint Committee on Taxation, "Explanation of Proposed Protocol to the Income Tax Treaty Between the United States and Denmark" (JCX–46–07), July 13, 2007; Joint Committee on Taxation, "Explanation of Proposed Protocol to the Income Tax Treaty Between the United States and Germany" (JCX–47–07), July 13,

pamphlets also provide detailed discussions of issues raised by the proposed treaty and protocols. We consulted with the Treasury Department and with the staff of your committee in analyzing the proposed treaty and protocols and in preparing the pamphlets.

The principal purposes of the treaty and protocols 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 taxes of the two countries. The proposed treaty and protocols also are intended to promote close economic cooperation between the treaty countries and to eliminate possible barriers to trade and investment caused by overlapping taxing jurisdictions of the treaty countries. As in other U.S. tax treaties, these objectives principally are 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.

The proposed treaty with Belgium would replace an existing treaty signed in 1970 and modified by a protocol signed in 1987. The proposed protocol with Denmark would amend an existing tax treaty that was signed in 1999. The proposed protocol with Finland would make several modifications to an existing treaty that was signed in 1989. The proposed protocol with Germany would update the existing treaty and protocol that were signed in 1989.

My testimony today will highlight some of the key features of the proposed treaty and protocols and certain issues that they raise.

U.S. MODEL TREATY

As a general matter, U.S. model tax treaties provide a framework for U.S. tax treaty policy and a starting point for tax treaty negotiations with our treaty partners. These models provide helpful information to taxpayers, the Congress, and foreign governments as to U.S. policies on tax treaty matters. Periodically updating the U.S. model tax treaty to reflect changes, revisions, developments, and the viewpoints of Congress with regard to U.S. tax treaty policy ensures that the model treaties remain meaningful and relevant. In November 2006, the Treasury Department released a new model income tax treaty; the U.S. model income tax treaty had not been updated since 1996.[3] As a general matter, the 2006 U.S. model treaty incorporates the key developments in U.S. income tax treaty policy that are reflected in recent U.S. income tax treaties. The proposed treaty and protocols that are the subject of this hearing are generally consistent with the provisions found in the 2006 U.S. model treaty. However, there are some key differences from the 2006 U.S. model treaty that I will discuss.

Limitation-on-benefits provisions

One area in which the proposed treaty and protocols are generally consistent with the 2006 U.S. model treaty is the inclusion in all four proposed instruments of a comprehensive limitation-on-benefits provision. The limitation-on-benefits provision of the 2006 U.S. model treaty reflects significant changes to the limitation-on-benefits provision of the United States Model Income Tax Convention of September 15, 1996. These changes generally are intended to make it more difficult for third country residents to benefit inappropriately from a treaty between two countries.

When a resident of one country derives income from another country, the internal tax rules of the two countries may cause that income to be taxed in both countries. One purpose of a bilateral income tax treaty is to allocate taxing rights for cross-border income and thereby to prevent double taxation of residents of the treaty countries. Although a bilateral income tax treaty is intended to apply only to residents of the two treaty countries, residents of third countries may attempt to benefit from a treaty by engaging in treaty shopping. This treaty shopping may involve organizing in a treaty country a corporation that is entitled to the benefits of the treaty or engaging in income-stripping transactions with a treaty-country resident. Limitation-on-benefits provisions are intended to deny treaty benefits in certain cases of treaty shopping.

The limitation-on-benefits provisions in the proposed treaty and protocols are generally similar to the limitation-on-benefits provisions in one another, in recent U.S. tax treaties, and in the 2006 U.S. model treaty. However, there are some differences. First, the public trading test in the limitation-on-benefits provision in the

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2007; Joint Committee on Taxation, "Explanation of Proposed Protocol to the Income Tax Treaty Between the United States and Finland" (JCX–48–07), July 13, 2007.

[3] For a comparison of the 2006 U.S. model income tax treaty with its 1996 predecessor, see Joint Committee on Taxation, "Comparison of the United States Model Income Tax Convention of September 15, 1996 with the United States Model Income Tax Convention of November 15, 2006" (JCX–27–07), May 8, 2007.

proposed protocol with Germany may be satisfied only if the principal class of a company's shares is primarily traded on a recognized stock exchange located in the company's country of residence. This rule is the same as the rule in the 2006 U.S. model treaty. The public trading tests in the proposed treaty with Belgium and in the proposed protocols with Denmark and Finland may be satisfied by trading on a stock exchange located in a company's country of residence or in one of various other countries that are considered to be part of the economic area that includes the applicable treaty country. Second, the proposed treaty and the three proposed protocols include so-called derivative benefits rules intended to grant treaty benefits to a treaty country resident if the resident's owners would have been entitled to the same benefits if the income had flowed directly to them. Third, the proposed treaty and the three proposed protocols include rules intended to foreclose eligibility for treaty benefits for certain triangular arrangements, arrangements in which income such as interest on a loan is lightly taxed because it is derived by a third-country permanent establishment of a treaty country resident. The 2006 U.S. model treaty does not include special derivative benefits rules or rules for triangular arrangements.

The proposed treaty with Belgium and the proposed protocols with Denmark and Germany have special limitation-on-benefits rules that are not included in the 2006 U.S. model treaty. The proposed treaty with Belgium includes rules intended to allow treaty benefits to certain treaty country residents that function as headquarters companies. Although the 2006 U.S. model treaty does not include special limitation-on-benefits rules for headquarters companies, similar rules have been included in U.S. income tax treaties with Australia and the Netherlands. The proposed protocol with Denmark includes rules intended to allow treaty benefits to certain Danish taxable nonstock corporations and to Danish companies owned by taxable nonstock corporations. Taxable nonstock corporations are entities designed to preserve control of certain Danish operating companies through control of the companies' voting stock. The proposed protocol with Germany includes special rules for determining whether certain German investment vehicles are entitled to treaty benefits.

"Zero-rate" dividend provisions

One significant difference between the 2006 U.S. model treaty and the proposed treaty and protocols is the "zero rate" of withholding tax on certain intercompany dividends provided under all four of the proposed instruments. Until 2003, no U.S. income tax treaty provided for a complete exemption from dividend withholding tax, and the 2006 U.S. model treaty and the 2005 Model Convention on Income and Capital of the Organisation for Economic Cooperation and Development ("OECD") do not provide an exemption. By contrast, many bilateral income tax treaties of other countries eliminate withholding taxes on direct dividends between treaty countries, and the European Union ("EU") Parent-Subsidiary Directive repeals withholding taxes on intra-EU direct dividends. The directive's required ownership threshold for qualification for zero withholding is 15 percent in 2007. Recent U.S. income tax treaties and protocols with Australia, Japan, Mexico, the Netherlands, Sweden, and the United Kingdom include zero-rate provisions. The Senate ratified those treaties and protocols in 2003 (Australia, Mexico, United Kingdom), 2004 (Japan, Netherlands), and 2006 (Sweden). The zero-rate provisions in those treaties are similar to the provisions in the proposed treaty and protocols.

In general, the dividend articles of the proposed treaty and protocols provide a maximum source-country withholding tax rate of 15 percent and a reduced 5-percent maximum rate for dividends received by a company owning at least 10 percent of the dividend-paying company. The proposed treaty and protocols generally provide a zero rate of withholding tax on certain dividends received by a parent company from a subsidiary that is at least 80 percent owned by the parent. Eligibility for this zero rate is contingent on satisfaction of more stringent limitation-on-benefits requirements than generally apply under the proposed treaty and protocols. A zero rate also generally is available under the proposed treaty and protocols for dividends received by a pension fund. The treaty and protocols also include special rules for dividends received from U.S. regulated investment companies and real estate investment trusts. These special rules generally are similar to provisions included in other recent U.S. treaties and protocols.

The zero-rate provision in the proposed treaty with Belgium includes two unique features. First, the required ownership threshold for dividends paid by Belgian companies to U.S. companies is 10 percent rather than 80 percent. Second, the provision allows the United States to terminate the zero-rate provision for dividends paid by U.S. companies if Belgium fails to comply with certain obligations under the exchange-of-information and mutual-agreement procedure provisions. The zero rate for

dividends paid by U.S.-resident companies will terminate for amounts paid or credited on or after January 1 of the 6th year following the year in which the proposed treaty enters into force unless by June 30 of the preceding year the U.S. Treasury Secretary, on the basis of a report of the IRS Commissioner, certifies to the U.S. Senate that Belgium has satisfactorily complied with its obligations under article 25 (Exchange of Information and Administrative Assistance). The United States also may terminate the zero-rate provision for dividends paid by U.S. companies if the United States determines that Belgium's actions under article 24 (Mutual Agreement Procedure) and article 25 (Exchange of Information and Administrative Assistance) have materially altered the balance of benefits of the proposed treaty. If the United States terminates the zero-rate provision, Belgium will not be required to comply with exchange-of-information rules specifically requiring the treaty countries to provide information held by banks and other financial institutions and by nominees and persons acting in agency or fiduciary capacities.

Notwithstanding the fact that zero-rate provisions are common in recent U.S. treaties, the 2006 U.S. model treaty does not include a zero-rate provision, nor do recent treaties with Bangladesh and Sri Lanka nor the recent protocol with France. In previous testimony before the committee, the Treasury Department has indicated that zero-rate provisions should be allowed only under treaties that have restrictive limitation-on-benefits rules and that provide comprehensive information exchange. Even in those treaties, according to previous Treasury Department statements, dividend withholding tax should be eliminated only based on an evaluation of the overall balance of benefits under the treaty. Looking beyond the four treaty relationships directly at issue, the committee may wish to consider what overall balance considerations might prompt the Treasury Department not to seek a zero-rate provision in a treaty that has limitation-on-benefits and information-exchange provisions meeting the highest standards, such as those found in the 2006 U.S. model treaty.

MANDATORY AND BINDING ARBITRATION PROVISIONS

One new feature of the proposed treaty with Belgium and the proposed protocol with Germany is the mandatory and binding arbitration provision. The provision does not appear in the 2006 U.S. model treaty or in any existing U.S. tax treaty. However, the use of mandatory and binding arbitration procedures in tax disputes between countries is not a completely novel concept. Earlier this year, the OECD Committee on Fiscal Affairs adopted proposed changes to its model treaty and commentary that incorporate a mandatory and binding arbitration procedure, some elements of which are generally similar to those of the proposed treaty and protocol. In addition, the EU has adopted certain mandatory and binding arbitration procedures that are applicable to transfer pricing disputes between 15 of the oldest members of the EU. There have been statements made by the European Commission that the EU mandatory arbitration procedure is not working as well as it is supposed to, for reasons that need to be further explored.

Judging from the actions taken by the OECD and the EU, unresolved competent authority proceedings appear to be a multinational occurrence. However, the information that would help clarify whether this phenomenon represents a problem for the U.S. competent authority program, as well as the information that would identify the extent of the problem and its root causes, is not publicly available. Consequently, if unresolved competent authority proceedings are a problem for the United States, it is difficult to determine whether mandatory and binding arbitration would solve it. The committee may wish to assess the basis for the Treasury Department, or taxpayers, to believe that there is a problem with the current resolution of disputes through the competent authority process. Are problems that have been identified pervasive or idiosyncratic to specific countries or tax issues?

As a general matter, it is beneficial to resolve tax disputes effectively and efficiently. The new arbitration procedures are intended to ensure that the mutual agreement procedures proceed according to a schedule and that all cases will be resolved within a limited time period. There are many potential variations of the arbitration methodology, however, and the committee may wish to consider the rationale for some of the choices made by the United States and its treaty partners and whether those chosen methodologies help to resolve the perceived problem. For example, the proposed arbitration procedures utilize the "last best offer" method. Under the "last best offer" method (also informally called "baseball arbitration" because it is similar to the arbitration method used to resolve major league baseball salary disputes), each of the treaty countries submits to the arbitration board ("board") a proposed resolution describing its proposed disposition of the specific amounts of income, expense, or taxation at issue in the case (and a supporting position paper), and the board is required to adopt one of the proposed resolutions sub-

mitted by the treaty countries. The determination of the board is binding upon the treaty countries in the case, but does not state a rationale and has no precedential value. The last best-offer approach is intended to induce the competent authorities to moderate their positions, including before arbitration proceedings would commence, thus increasing the possibility of a negotiated settlement. The proposed arbitration procedures do not adopt the "independent opinion" approach, under which the board is presented with the facts and arguments of the parties based on applicable law and then reaches its own independent decision based upon a written, reasoned analysis of the facts involved and applicable legal sources. Other examples of choices made are the lack of provision for taxpayer involvement in the arbitration proceedings and the absence of feedback to the competent authorities regarding the rationale for the board's determination.

The proposed mandatory and binding arbitration procedures are new to the United States treaty network. It will take time to ascertain if these procedures are effective or if unexpected problems arise. Meanwhile, the Treasury Department or other trading partners may seek to negotiate treaty provisions with current or future treaty partners that are similar, in whole or in part, to the arbitration procedures of the proposed treaty and protocol. The committee may wish to better understand how the Treasury Department intends to monitor the competent authority function, as well as arbitration developments with respect to other countries, to determine the overall effects of the new arbitration procedures on the mutual agreement process. The committee may wish to consider what types of information are needed to measure whether, regardless of whether they are availed of, the proposed arbitration procedures result in more efficient case resolution, both before and during arbitration, and whether they enhance the quality of the outcome of the competent authority cases. In addition, the committee may wish to inquire as to whether and under what circumstances the Treasury Department intends to pursue similar provisions in other treaties.

BELGIUM

The proposed treaty replaces the existing treaty (signed in 1970) and protocol (signed in 1987). In addition to the inclusion of a comprehensive limitation-on-benefits provision, a zero-rate dividend provision, and a mandatory and binding arbitration provision, as previously discussed, the proposed treaty has several other key features.

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 (article 7). Similarly, the proposed treaty contains certain 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 14 and 16).

The proposed treaty provides that, subject to certain rules and exceptions, interest and royalties derived by a resident of either country from sources within the other country may be taxed only by the residence country (articles 11 and 12).

In situations in which 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 22).

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). This provision also allows the United States to tax certain former citizens and long-term residents regardless of whether the termination of citizenship or residency had as one of its principal purposes the avoidance of tax. The provision generally allows the United States to apply special tax rules under section 877 of the Code as amended in 1996 and 2004. In addition, the proposed treaty contains the standard provision providing that the treaty may not be applied to deny any taxpayer any benefits to which the taxpayer would be entitled under the domestic law of a country or under any other agreement between the two countries (article 1).

The proposed treaty adds to the present treaty certain provisions regarding cross-border contributions to, and benefit accruals of, pension plans (article 17). These rules are intended to remove barriers to the flow of personal services between the two countries that could otherwise result from discontinuities under the laws of

each country and are similar to provisions included in other recent U.S. treaties and protocols, including the 2006 U.S. model treaty.

The proposed treaty (article 19) generally provides that students, teachers, business trainees, and researchers visiting the other treaty country are exempt from host country taxation on certain types of payments received.

The proposed treaty provides authority for the two countries to exchange information (article 25) and assist in the collection of tax (article 26) in order to carry out the provisions of the proposed treaty.

DENMARK

The proposed protocol makes a few modifications to the 1999 treaty, in addition to the adoption of the comprehensive limitation-on-benefits provision and the zero-rate dividends provision previously discussed.

The proposed protocol expands the saving clause provision in article 1 (Personal Scope) of the existing treaty to allow the United States to tax certain former citizens and long-term residents regardless of whether their termination of citizenship of residency has as one of its principal purposes the avoidance of tax. This provision generally allows the United States to apply special tax rules under section 877 of the Code as amended in 1996 and 2004.

The proposed protocol amends article 19 (Government Service) of the existing treaty to correct a drafting error that inappropriately expands the scope of an exception to the general rule governing the taxation of certain government pensions.

FINLAND

The proposed protocol makes several modifications to the 1989 treaty, in addition to the adoption of the comprehensive limitation-on-benefits provision and the zero-rate dividends provision previously discussed.

The proposed protocol expands the saving clause provision in article 1 (Personal Scope) of the existing treaty to allow the United States to tax certain former citizens and long-term residents regardless of whether the termination of citizenship or residency had as one of its principal purposes the avoidance of tax. This provision generally allows the United States to apply special tax rules under section 877 of the Code as amended in 1996 and 2004. The proposed protocol makes coordinating changes to article 23 (Elimination of Double Taxation) with respect to foreign tax credits allowed for former U.S. citizens and long-term residents.

The proposed protocol also adds to article 1 (Personal Scope) of the existing treaty rules included in recent U.S. treaties and the 2006 U.S. model treaty related to fiscally transparent entities.

The proposed protocol amends article 4 (Residence) of the existing treaty to clarify which persons are residents of a treaty country and to more closely reflect the provisions included in the 2006 U.S. model treaty and recent U.S. income tax treaties.

The proposed protocol modifies article 11 (Interest) and article 12 (Royalties) of the existing treaty. It adds to article 11 two new exceptions to the general prohibition on source-country taxation of interest income, one for contingent interest and the other for interest that is an excess inclusion with respect to a residual interest in a real estate mortgage investment conduit. It amends article 12 by deleting a paragraph that permits source-country taxation of royalties that are beneficially owned by a resident of the other treaty country and that are received as consideration for the use of patents and trademarks or for information concerning industrial, commercial, or scientific experience.

The proposed protocol replaces article 26 (Exchange of Information) of the existing treaty with new exchange-of-information rules that are largely similar to the exchange-of-information rules included in the 2006 U.S. model treaty.

The proposed protocol will enter into force upon the exchange of instruments of ratification. If the proposed protocol enters into force before December 31, 2007, the dividend withholding tax provisions will have effect for income derived on or after January 1, 2007.

GERMANY

The proposed protocol makes several modifications to the 1989 treaty and protocol, in addition to the adoption of the comprehensive limitation-on-benefits provision, the zero-rate dividends provision, and the mandatory and binding arbitration provision previously discussed.

The proposed protocol expands the saving clause provision in article 1 (General Scope) of the existing treaty to allow the United States to tax certain former citizens and long-term residents regardless of whether the termination of citizenship or residency had as one of its principal purposes the avoidance of tax. This provision gen-

erally allows the United States to apply special tax rules under section 877 of the Code as amended in 1996 and 2004. The proposed protocol also updates the existing treaty to include the rules in the 2006 U.S. model treaty related to fiscally transparent entities.

The proposed protocol amends article 4 (Residence) of the existing treaty to clarify which persons are residents of a treaty country. The proposed protocol specifically addresses the residence of the two treaty countries (and subdivisions and local authorities thereof), U.S. citizens and aliens lawfully admitted for permanent residence in the United States, and certain investment funds.

The proposed protocol modifies article 7 (Business Profits) in two important respects. First, the protocol modifies article 7 to provide that income derived from independent personal services (i.e., income from the performance of professional services and of other activities of an independent character) is included within the meaning of the term "business profits." Accordingly, the treatment of such income is governed by article 7 rather than by present treaty article 14 (Independent Personal Services), which the proposed protocol deletes. In addition, paragraph 4 of article XVI provides that the OECD Transfer Pricing Guidelines apply by analogy in determining the profits attributable to a permanent establishment under article 7. These new rules are similar to provisions included in other recent U.S. treaties and protocols, including the 2006 U.S model treaty.

The proposed protocol adds to the present treaty article 11 (Interest) two new exceptions to the general prohibition on source-country taxation of interest income; one for contingent interest and the other for interest that is an excess inclusion with respect to a residual interest in a real estate mortgage investment conduit.

The proposed protocol adds to the present treaty article 18A (Pension Plans). Article 18A includes new rules related to cross-border pension contributions and benefit accruals. These rules are intended to remove barriers to the flow of personal services between the two countries that could otherwise result from discontinuities under the laws of each country regarding the deductibility of pension contributions and the taxation of a pension plan's earnings and accretions in value. These new rules are similar to provisions included in other recent U.S. treaties and protocols, including the 2006 U.S model treaty.

The proposed protocol replaces article 19 (Government Service) of the existing treaty with a new article that more closely reflects the government service provisions included in the 2006 U.S. model treaty and recent U.S. income tax treaties.

The proposed protocol modifies article 20 (Visiting Professors and Teachers; Students and Trainees) of the existing treaty to provide that professors or teachers who visit the other treaty country for a period that exceeds 2 years do not retroactively lose their exemption from host-country income tax. The proposed protocol increases the amount of the exemption from host-country tax for students and trainees who receive certain types of payments.

The proposed protocol replaces article 23 (Relief From Double Taxation) of the present treaty with a new article providing updated rules for the relief of double taxation. Among other changes, the new article 23 provides special rules for the tax treatment in both treaty counties of certain types of income derived from U.S. sources by U.S. citizens who are resident in Germany.

The proposed protocol updates article 17 (Artistes and Athletes) and article 20 (Visiting Professors and Teachers; Students and Trainees) of the existing treaty to reflect Germany's use of the euro.

The proposed protocol provides for the entry into force of the proposed protocol. The provisions of the proposed protocol are generally effective on a prospective basis. However, the provisions of the proposed protocol with respect to withholding taxes are effective for amounts paid or credited on or after the first day of January of the year in which the proposed protocol enters into force.

CONCLUSION

These provisions and issues are all discussed in more detail in the Joint Committee staff pamphlets on the proposed treaty and protocols. I am happy to answer any questions that the committee may have at this time or in the future.

Senator MENENDEZ. Thank you.

Turning to the intellectual property treaties, Ms. Boland.

STATEMENT OF LOIS E. BOLAND, DIRECTOR OF THE OFFICE ON INTERNATIONAL RELATIONS, U.S. PATENT AND TRADEMARK OFFICE, DEPARTMENT OF COMMERCE, WASHINGTON, DC

Ms. BOLAND. Mr. Chairman, Senator Lugar, thank you for this opportunity to discuss, and urge support for, ratification of three important intellectual property treaties.

These treaties involve patent, design patent, and trademark protection. They are similar, in that each will serve to streamline and simplify procedures for American innovators and businesses, especially independent inventors and small business desiring to protect their intellectual property abroad.

The first is a treaty on industrial designs, commonly referred to as the Hague Agreement. It provides a streamlined protection system for American owners of industrial designs who, by filing a single standardized application at the United States Patent and Trademark Office, in English, can apply for design protection in each country that is party to the act. Currently, a U.S. design applicant must file separate applications for protection in each country in which protection is sought.

In terms of benefits, we anticipate that the centralized registration procedure under the treaty will result in cost savings to American industrial designowners and lead to fewer processing mistakes and delays on the part of both the applicant and the relevant foreign patent offices.

Mr. Chairman, a draft implementing bill for the treaty's provisions will be sent to the Hill this week. It will require a number of limited changes in the U.S. design patent law, including providing limited rights to design patentees between publication and grant dates and extending the design patent term from 14 to 15 years from grant.

The second treaty, the Patent Law Treaty, or PLT, promotes patent protection by codifying, streamlining, and reducing the costs associated with obtaining and maintaining patents throughout the world. Because patents are territorial, inventors need to seek a patent in each country in which they desire protection. Differences in the formal requirements of a patent application in each country or region make filing patent applications complex and expensive. The PLT will help U.S. businesses and independent inventors by simplifying the process of obtaining patent protection, and thereby, reduce associated costs. It sets forth, with one exception, the maximum formal requirements that parties to the treaty may impose on patent applicants and patentees.

The PLT also standardizes requirements for obtaining a filing date and provides that applicants cannot be required to hire representation for the act of filing an application or paying certain fees.

The President has recommended that a reservation to the PLT be included in the U.S. instrument of ratification that clarifies that the United States will maintain its law relating to unity of invention. A few minor amendments to the U.S. patent law will be necessary in order to implement the PLT, relating to application filing dates, time limits, and priority rights. Draft legislation implementing those changes was forwarded to the Hill yesterday.

The third treaty is the Singapore Treaty on the Law of Trademarks, or the Singapore Treaty. This treaty updates and improves the world Intellectual Property Organization Trademark Law Treaty of 1994 by allowing its contracting parties to move to a totally electronic filing and processing system. It also establishes an assembly to oversee matters concerning the treaty, provides relief for missed deadlines, and expands the TLT to apply to trademarks consisting of nonvisible signs.

Most significantly, the Singapore Treaty addresses the No. 1 complaint by U.S. businesses concerning trademark registrations in other countries; namely, trademark license recordal requirements. Many countries that require recordal of trademark license contracts require certified signatures of both parties, a certified copy of the entire license agreement, and various other formalities not strictly necessary for the act of recording the license. Those requirements are burdensome, time-consuming, and costly for U.S. businesses. Also, in a number of countries, failure to record can result in the loss of the underlying trademark registration. The United States does not require recordal of trademark licenses.

The Singapore Treaty imposes limits on these license recordal requirements, as well as on the penalties associated with a failure to record. These limitations will greatly benefit American entities doing business in foreign countries.

Ratification of the Singapore Treaty will not require implementing legislation, because U.S. law and practice is already in full compliance with the provisions of the treaty.

Mr. Chairman, in summary, these three treaties will help American businesses establish, maintain, and protect their intellectual property abroad. On behalf of the administration, we respectfully urge ratification and thank you for your consideration.

[The prepared statement of Ms. Boland follows:]

PREPARED STATEMENT OF LOIS E. BOLAND, DIRECTOR, OFFICE OF INTERNATIONAL RELATIONS, U.S. PATENT AND TRADEMARK OFFICE, DEPARTMENT OF COMMERCE, WASHINGTON, DC

Chairman Biden, Ranking Member Lugar, and members of the committee, thank you for this opportunity to appear before you to discuss and urge support for ratification of three important intellectual property treaties. These treaties, while addressing three different types of intellectual property, are similar in that they each will serve to streamline and simplify procedures for American innovators and businesses seeking to protect their intellectual property abroad.

GENEVA ACT OF THE HAGUE AGREEMENT

Mr. Chairman, the first treaty is the "Geneva Act of the Hague Agreement Concerning the International Registration of Industrial Designs." It is commonly referred to as the "Geneva Act of the Hague Agreement" or "Hague Agreement."

This treaty promotes the ability of American design owners to protect their industrial designs by allowing them to obtain multinational design protection through a single international application procedure. It provides a streamlined design protection system for American owners of industrial designs who, by filing a single standardized application at the United States Patent and Trademark Office (USPTO), in English, can apply for design protection in each country that is Party to the Act. Similarly, renewal of a design registration in each Party to the Act may be made by filing a single request along with payment of the appropriate fees at the International Bureau of the World Intellectual Property Organization (WIPO).

Currently, a U.S. design applicant must file separate applications for design protection in each country. We anticipate that the centralized registration procedure under the Hague Agreement will result in cost savings to American industrial de-

sign owners and lead to fewer processing mistakes and delays on the part of both the applicant and the relevant foreign patent offices.

The United States is one of relatively few countries that provide for a substantive examination of design applications with respect to novelty and nonobviousness. The Hague Agreement was negotiated with the needs of those examining offices, such as the USPTO, in mind. The USPTO will maintain its substantive examination process for design patent applications under the Hague Agreement.

However, the implementation of the Hague Agreement does require a number of limited changes in U.S. design patent law including (1) providing limited rights to patent applicants between the date that their international design application is published and the date on which they are granted a U.S. patent based on that application, (2) extending the patent term for designs from 14 to 15 years from grant and (3) allowing the USPTO to use a published international design registration as a basis for rejecting a subsequently filed patent application that is directed at the same or similar subject matter.

Mr. Chairman, the administration will be forwarding recommended implementing legislation in the near future.

PATENT LAW TREATY

The second treaty, the Patent Law Treaty, or "PLT," promotes patent protection by codifying, harmonizing, and reducing the costs of taking the steps necessary for obtaining and maintaining patents throughout the world. The provisions set forth in the PLT will safeguard American commercial interests by making it easier for our patent applicants and owners to protect their intellectual property worldwide.

In today's innovation-based, global economy, a patent is an important tool to protect a company's intellectual contributions, and is one of its most important commercial assets. A global patent portfolio can be expensive, however, to establish and maintain. This is because patents are only enforceable in the country or region in which they are granted. Because patents are territorial, inventors need to seek patent protection in each country in which they desire patent protection. As a result, differences in formal requirements of a patent application in each country (or region) can make filing patent applications complex and expensive. The PLT will help U.S. businesses and independent inventors by simplifying the process of obtaining patent protection and, thereby, reduce the associated cost.

The PLT addresses procedural requirements of a patent application, and generally sets forth the maximum procedural requirements that can be imposed. It standardizes requirements for obtaining a filing date, and provides that applicants cannot be required to hire representation for the act of filing an application or to pay certain fees. The PLT does not limit the United States from providing patent requirements that are more favorable to the patent applicant or patent owner than those set forth in the PLT or from prescribing requirements that are provided for in our substantive law relating to patents.

The PLT sets forth, with one exception, maximum formal requirements that Parties to the PLT may impose on patent applicants and patentees. Otherwise, Parties are free to provide requirements that, from the viewpoint of applicants and owners, are more favorable than PLT requirements. The one exception to this freedom is the filing date provision, which is both a maximum and a minimum, i.e., a "filing date standard."

Because the USPTO assesses that implementing a provision of the PLT requiring "unity of invention"—a standard that is substantively at odds with the corresponding U.S. standard—would require a substantive and impractical change to our patent law, the President has recommended that the following reservation be included in the U.S. instrument of ratification, as allowed by the treaty: "Pursuant to Article 23, the United States declares that Article 6(1) shall not apply to any requirement relating to unity of invention applicable under the Patent Cooperation Treaty to an international application."

Upon entry into force, the PLT will simplify the formal procedures [or "requirements"] and reduce associated costs for patent applicants and owners of patents in obtaining and preserving their rights in inventions in many countries of the world.

A few amendments to the U.S. patent law will be necessary in order to implement the PLT. Minor changes in title 35, United States Code, will be required relating to: (a) Patent application filing dates, (b) relief in respect of time limits and reinstatement of rights and (c) the restoration of the priority right.

Mr. Chairman, the administration forwarded the recommended implementing legislation yesterday.

SINGAPORE TREATY ON THE LAW OF TRADEMARKS

The third intellectual property treaty is the Singapore Treaty on the Law of Trademarks or the "Singapore Treaty." This treaty updates and improves the World Intellectual Property Organization Trademark Law Treaty of 1994 (TLT) that harmonizes formalities and simplifies procedures for registering and renewing trademarks.

Consistent with the USPTO's e-government efforts, the Singapore Treaty updates TLT by allowing its Contracting Parties to move to a totally electronic filing and processing system. The Singapore Treaty also establishes an Assembly to oversee matters concerning the treaty; provides relief measures for deadlines missed by the trademark applicant or registrant; and expands the TLT to apply to trademarks consisting of nonvisible signs, in line with Free Trade Agreements entered into by the United States.

Most significantly, the Singapore Treaty also addresses the No. 1 complaint by U.S. businesses concerning trademark registrations in other countries; namely, trademark license recordal requirements. Many countries that record trademark license contracts require certified signatures of both parties, a certified copy of the entire license agreement, and various other formality requirements that may not be strictly necessary for the act of recording the license. Certainly these requirements are burdensome, time-consuming and costly for businesses having to record those trademark licenses. Moreover, in a number of countries, failure to record a license contract with a government agency can result in invalidation of the underlying trademark registration. The Singapore Treaty imposes limits on license recordal requirements as well as on those penalties associated with the failure to record licenses in order to simplify and reduce costs associated with this formality laden recordal process for U.S. businesses as well as to minimize the damage that may emanate from a failure to record licenses in those countries that are party to the treaty. The United States does not require recordal of trademark licenses.

Mr. Chairman, ratification of the Singapore Treaty will not require implementing legislation because U.S. law is already in compliance with the provisions of the treaty.

CONCLUSION

Mr. Chairman, in summary, these three treaties will help American businesses establish, maintain, and protect their intellectual property abroad. On behalf of the administration, we respectfully urge ratification. Thank you for your consideration.

Senator MENENDEZ. Thank you very much.

Mr. Scholz, how much time to you need? I don't want to shortchange you. It's just the vote is well underway, and I wanted to get a sense of—5, 7 minutes?

Mr. SCHOLZ. Approximately 3 minutes, Mr. Chairman.

Senator MENENDEZ. Three minutes? Then, I'd love to hear you now. [Laughter.]

STATEMENT OF WESLEY SCHOLZ, DIRECTOR OF THE OFFICE OF INVESTMENT AFFAIRS, DEPARTMENT OF STATE, WASHINGTON, DC

Mr. SCHOLZ. Thank you, Mr. Chairman. And thank you for the opportunity to testify before the Senate Foreign Relations Committee as the administration seeks advice and consent of the Senate to the ratification of the protocol to our Treaty of Friendship, Commerce, and Navigation with Denmark.

The protocol will establish the legal basis by which the United States may issue treaty investor visas, also known as E–2 visas, to qualified nationals of Denmark under the FCN Treaty.

United States investors interested in investing in Denmark are already eligible for Danish visas that offer comparable benefits to those that would be accorded to nationals of Denmark by this protocol. The United States has a longstanding policy of openness to foreign investment. As President Bush stated on May 10 of this

year, a free and open international investment regime is vital for a stable and growing economy both here at home and throughout the world.

Foreign investment in the United States strengthens our economy and improves productivity, provides good jobs, and spurs healthy competition. Americans have prospered as foreign companies have put their money to work here in the United States. Foreign companies in the United States employed more than 5 million U.S. workers in 2005, providing 4.5 percent of all private sector employment in the United States. Visas for investors facilitate investment in the United States.

The United States and Denmark have a strong and growing economic relationship. According to Department of Commerce statistics, the stock of Danish direct investment in the United States totaled over $7 billion at the end of 2006. And United States direct investment in Denmark amounted to about $5.8 billion.

The protocol will facilitate Danish investment in the United States by making Danish investors who invest substantial capital in the United States eligible for consideration to receive treaty investor visas under the Immigration and Nationality Act. The principal substantive article of the protocol provides that nationals of either contracting party shall be permitted, subject to the laws relating to entry and sojourn of aliens, to enter the territories of the other party and to remain there for the purpose of developing and directing the operations of an enterprise in which they have invested, or in which they are actively in the process of investing, a substantial amount of capital.

Although most U.S. FCN treaties contain a provision qualifying the treaty partner's nationals for E–2 visas, the United States-Denmark FCN Treaty does not. The protocol is intended to overcome this deficiency.

Denmark is a close ally, and our relations with Denmark are excellent. Despite its small geographic size and population of only 5.4 million people, Denmark plays an important role in the international community and is an effective friend and ally within NATO, the European Union, and the United Nations. It has engaged fully in the world events, while maintaining a strong Atlantic perspective. With forces deployed in Iraq, Afghanistan, and Kosovo, Denmark is active in peacekeeping and stabilization operations, and is also one of the largest per-capita donors of foreign aid.

Regionally, Denmark serves as a vital gateway to other Nordic and Baltic states, and Copenhagen is a key regional transportation hub. The United States is Denmark's largest non-EU trading partner. American-made aircraft, machinery, computers, and other products comprise about 6 percent of Denmark's total imports.

In conclusion, the administration wishes to thank the committee for its consideration of the protocol, and we urge you to report it favorably to the full Senate for action.

Thank you.

[The prepared statement of Mr. Scholz follows:]

PREPARED STATEMENT OF WESLEY S. SCHOLZ, DIRECTOR, OFFICE OF INVESTMENT AFFAIRS, DEPARTMENT OF STATE, WASHINGTON, DC

Mr. Chairman, thank you for the opportunity to testify before the Foreign Relations Committee as the administration seeks advice and consent of the Senate to ratification of the Protocol to our Treaty of Friendship, Commerce, and Navigation (FCN) with Denmark. The protocol will establish the legal basis by which the United States may issue treaty-investor visas—also known as "E–2" visas—to qualified nationals of Denmark under the FCN Treaty. United States investors interested in investing in Denmark are already eligible for Danish visas that offer comparable benefits to those that would be accorded nationals of Denmark interested in investing in the United States under E–2 visa status.

The United States has a longstanding policy of openness to foreign investment. As President Bush stated on May 10, "A free and open international investment regime is vital for a stable and growing economy, both here at home and throughout the world." Foreign investment in the United States strengthens our economy, improves productivity, provides good jobs, and spurs healthy competition. Americans have prospered as foreign companies have put their money to work here. Foreign companies in the United States employed more than 5 million U.S. workers in 2005, providing 4.5 percent of all private sector employment in the United States. Visas for investors facilitate investment in the United States.

The United States and Denmark have a strong and growing economic relationship. According to Department of Commerce statistics, Danish direct investment in the United States on a historical cost basis totaled over $7 billion at the end of 2006, and U.S. direct investment in Denmark amounted to about $5.8 billion. U.S. investments in Denmark accounted for 11 percent of total foreign direct investment stock in that country in 2005, making the United States the second-largest source of foreign investment in Denmark. Approximately 375 U.S. companies have subsidiaries in Denmark, of which several are regional headquarters. Economic sectors that are host to major U.S. direct investment in Denmark include telecommunications, information technology, biotechnology, oil exploration, financial services, and facility services.

The Protocol will facilitate Danish investment in the United States by making Danish investors, who invest substantial capital in the United States, eligible for consideration to receive treaty investor visas under the Immigration and Nationality Act (INA). The relevant provision of the INA, section 101(a)(15)(E)(ii), permits issuance of an E–2 visa only to a nonimmigrant who is "entitled to enter the United States under and in pursuance of the provisions of a treaty of commerce and navigation between the United States and the foreign state of which he is a national . . . solely to develop and direct the operation of an enterprise in which he has invested, or of an enterprise in which he is actively in the process of investing, a substantial amount of capital."

The principal substantive article of the Protocol provides that "[n]ationals of either Contracting Party shall be permitted, subject to the laws relating to the entry and sojourn of aliens, to enter the territories of the other Party and to remain therein for the purpose of developing and directing the operations of an enterprise in which they have invested, or in which they are actively in the process of investing, a substantial amount of capital."

Although most U.S. FCN treaties contain a provision qualifying the treaty partner's nationals for E–2 visas, the U.S.-Denmark FCN Treaty does not. The protocol is intended to overcome this deficiency. The protocol reflects language found in the INA and other U.S. FCN treaties—including more than a dozen modern FCN treaties—and investment treaties generally. European countries whose nationals are already eligible for E–2 visas include, for example, the United Kingdom, Germany, France, Italy, the Netherlands, Belgium, Norway, and Sweden.

Denmark is a close ally and our relations with Denmark are excellent. Despite its small geographic size and population of only 5.4 million people, Denmark plays a significant role in the international community and is an effective friend and ally within NATO, the European Union, and the United Nations. It is engaged fully in world events, while maintaining a strong Atlantic perspective. With forces deployed in Iraq, Afghanistan, and Kosovo, Denmark is active in peacekeeping and stabilization operations and is also one of the largest per capita donors of foreign aid. Regionally, Denmark serves as a vital gateway to the other Nordic and Baltic States and Copenhagen is a key regional transportation hub. The United States is Denmark's largest non-EU trading partner. American-made aircraft, machinery, computers, and other products comprise about 6 percent of Denmark's total imports.

In conclusion, the administration wishes to thank the committee for its consideration of the protocol and we urge you to report it favorably to the full Senate for action. I would be happy to answer any questions you may have.

Senator MENENDEZ. Thank you very much.

Thank you all.

The committee is going to stand in recess, subject to the call of the Chair, which I would expect would be about 20 to 25 minutes. I do have questions for this panel, so I'm going to ask you to stay. And, after that, any other members show up and have questions, we will then proceed to the second panel.

Until then, the committee in recess.

[Recess.]

Senator MENENDEZ. The committee will be back in order.

Let me thank you all for your patience.

Mr. Harrington, what's your view of the arbitration provisions in the German and Belgium agreements? Do you see them being used as a model for future agreements with other countries?

Mr. HARRINGTON. Thank you, Mr. Chairman.

We do believe that arbitration can be an effective tool to strengthen the mutual agreement procedures. Before I go too much further, I think it might be helpful to step back and note that the term "arbitration" probably means different things to different people. The process that we've designed, and that's in both the treaty with Belgium and with the protocol with Germany, is tailored to do a fairly narrow job, and that's to help the competent authorities reach agreement in cases where they've had trouble resolving an issue, and to do it on an expedited basis. So, the process allows each competent authority to make a final offer, and it allows the arbitration board to pick between these two final offers. The board's determination effectively becomes the competent authorities' agreement. The taxpayer treats that as any other decision of the competent authority and decides whether he wants to accept the decision or litigate or otherwise follow the normal procedures he has under domestic rules.

So, to our minds, this really is a way of facilitating agreement between the competent authorities, resolving disputes between the tax authorities. So, we think that what's in the Germany and the Belgium agreements is beneficial.

Also, as Mr. Barthold mentioned in his testimony, arbitration generically is becoming increasingly an issue. It's in the OECD model. He mentioned, for example, in the EU context, in transfer pricing, it exists. So, we do expect, in the context of treaties, that either the United States or the other country is going to raise arbitration on a going-forward basis. What we've designed is intended to resolve those disputes. We're hopeful that this is something that will lead to greater dispute resolution. So, it's something that we believe will help resolve disputes in the future by following that approach.

Senator MENENDEZ. Is there a view that, by virtue of having the arbitration provisions, there will be an incentive to actually settle, without necessarily having to go to arbitration itself?

Mr. HARRINGTON. Yes, Mr. Chairman. I think it goes back to Mr. Barthold's question about how you measure the success of arbitration. I mean, how do you measure whether it's working or not? On

one measure, it could be quite successful, even if it's never invoked. The experience that we've heard from other countries that have arbitration currently, is that it effectively lights a fire under the tax authorities to reach an agreement. If they're like me, they're not going to want someone else to make the decision. They'd rather resolve it themselves. So, in that sense, the expectation is that, in the vast majority of cases, because effectively the arbitrator would choose between two choices, it really should lead to the competent authorities moving closer to each other prior to arbitration.

Another potential effect of success, that isn't easily measured, is that it might actually lead to, potentially, more disputes being brought to the competent authorities. Currently, taxpayers might not bring disputes to the competent authorities because they're not sure the disputes are going to get resolved—it might be an area where there historically hasn't been resolution. If they know that there is going to be resolution, it might actually result in their bringing more potential disagreements. In that sense, it's probably bad from a pure resource sort of standpoint because it means more disputes, but it also means less double taxation, more resolution for taxpayers. So, I think that's potentially a positive thing from an overall reduction in double taxation.

Senator MENENDEZ. Well, to both you and Mr. Barthold, in order to know which way this is going to work, presuming the treaties are passed by the Senate, is there a mechanism by which we're going to be judging whether or not this is a successful provision that we might want to see more universally applied, whether they're being resolved before actually going to arbitration or seeing the other consequence that you just described?

Mr. BARTHOLD. Well, Mr. Chairman, I had tried to lay out our staff's thoughts on arbitration in three broad points. One, what are the problems that we see? Then, what is the process that we are going to do? In other words, what type of arbitration? And does that process fit the problems that we see? And then, that might guide us, in part, as to how we assess it. Our staff has heard comment that some people see problems in terms of length of resolution. Under the proposed process arbitration takes place at a certain point in times and then there is a certain period of time by which a resolution has to occur. That means that there is an end to the process.

If that is the sole source of the problem, then one might be able to easily assess the benefit of the arbitration procedure just by saying: Has resolution of questions that arise been sped up, compared to where there is no arbitration?

If, however, the problems are in the interpretation of law, it might be more difficult to assess whether we think the arbitration procedure leads to the right solution. It will lead to a solution, because you do have to have resolution—the arbitration board has to say this position or that position. But we'd have to think, I think, a little bit more about how to assess whether it gets to, sort of, a right solution, in a more legal sense.

Senator MENENDEZ. Do you have any comment on that, Mr. Harrington?

Mr. HARRINGTON. Yes. I would just say that we are keenly interested in monitoring the implementation of the arbitration provi-

sion. On one level, as with any provision of the treaty, as we gain more experience with anything that's new, we'll find certain refinements are necessary. And so, from that standpoint, I think we're very much interested in making sure that the provisions that we have work; and, if they don't work, how we can modify them, and make them work better. As part of that process, we will monitor the types of cases that go to arbitration, how they're resolved, whether the cases raise more factual or legal issues, things like that. Since the whole point is to increase the efficient, effective resolution of cases in the mutual agreement procedure before they reach arbitration, we'll discuss, with the competent authority, ways to assess if the provision is working as intended. You may get different answers under different treaties, but we are keenly interested in making sure that the arbitration process does operate properly.

Senator MENENDEZ. Now let me raise one other set of questions with both of you before I turn to the intellectual property treaties. And don't get nervous, because, when I raised this with staff, I was told that it makes a lot of people nervous just to even raise it; I'm not suggesting it for these treaties, but I think it's worthy of discussion; and that is, as I understand it, taxpayers themselves have no participation or say in the arbitration processes, as it's devised presently, is that correct? It's the authorities that deal with each other, but not the taxpayer——

Mr. HARRINGTON. Yes.

Senator MENENDEZ [continuing]. Themselves.

Mr. HARRINGTON. Yes. The provisions that are in the United States agreements with Belgium and Germany, they are between the competent authorities. They don't have specific rules for dealing with taxpayers.

Senator MENENDEZ. Well, one of the questions I raised before this hearing was, why don't we consider the possibility of taxpayer participation in the arbitration proceedings, since, at the end of the day, I assume that they would make the most compelling case, since they are the ones who are ultimately going to have to put forth the resources that would be decided. And so, what are the benefits and drawbacks of taxpayer participation? I'd invite either one of you to answer that question.

Mr. HARRINGTON. To a certain extent, that would depend on the design of the arbitration provision. If you were talking about a quasi-judicial arbitration that looked more like a court proceeding, then you would expect a lot more involvement in those sorts of situations.

The provision that we've designed in these treaties—because it's an extension of the competent-authority process—builds on the taxpayer involvement in the competent authority process. Typically, a dispute under the tax treaty comes up because the taxpayer has determined that one of the governments isn't taxing consistently with the treaty. So, it goes to the competent authority. In the United States, the U.S. taxpayer is going to typically go to the U.S. competent authority and say "This other country isn't engaging properly." The U.S. taxpayer will provide information to the competent authority. The competent authority takes that into account in presenting its case to the other competent authority. So, there

is taxpayer involvement with the competent authorities. But, in this particular arbitration process because it's, as was referred to earlier as baseball arbitration where effectively each competent authority makes one particular offer, you really only can have two parties involved making that particular offer. For example, if you have a third offer involved, you potentially would have a dispute with the three arbitrators. They might come up with three different decisions. So, again, this is very much a function of the design that it really needs to be between the competent authorities.

Plainly, we do want taxpayer involvement. We want the taxpayer to help with the facts; they can help get the right answer. But, at the end of the day, we have to have a situation that, one, is going to work in the context of the treaty, and, two, is also one that, depending on the circumstances, is acceptable to treaty partners. Some treaty partners are much more amenable to something that looks very much like the current system, less so to something that looks like it's a different sort of procedure than what they have experienced. We've certainly seen that anecdotally when it's come up before. So, our hope is to have as much taxpayer involvement as we can, but still within the context of the competent-authority process.

Senator MENENDEZ. Well, I know we're not necessarily talking about these treaties, but it's something that I think was an interest by some of us to look at. We believe that the taxpayer can play a more significant role than, certainly, these provisions call for right now, and still provide for a basis under which countries would still seek to enter into such an agreement. So, that's something we'll be discussing with you in the future.

But, let me turn to Ms. Boland. Let me ask you: Which other countries do you find the United States intellectual propertyholders most often seek protection of their intellectual property rights? And are these countries a party to the three intellectual property treaties we're considering today?

Ms. BOLAND. Thank you, Mr. Chairman.

I think that, in general, U.S. rightholders seek protection in Europe, either regionally or country by country—Japan, Russia, and some of the emerging markets in Asia, such as China and the Republic of Korea. I think that we have a little bit of a different situation for each of the treaties. For the Hague agreement, there are 23 countries that have joined the treaty, so—to date—where the only—what we would say, important players, from the U.S. perspective, are France, Spain, and Switzerland. The European community has indicated that it intends to join the agreement, and, once they do join the agreement, it will be a major benefit for U.S. rightholders to have the European community, as a bloc, in the agreement.

Japan and Canada, for the Hague, have indicated, informally to us in our discussions with them, bilaterally, that, once we join the Hague, they will follow suit.

For the Patent Law Treaty, 14 countries have joined the treaty. Most of those countries are rather small and not significant, in terms of trading partners with the United States, but the United Kingdom and Denmark have joined the treaties. Again, they are small, but they are important players for our rightholders.

For the PLT, many countries are waiting for the U.S. lead on this treaty, and we have had informal discussions with many of those countries, and they will likely follow our lead once we join.

On the Singapore TLT, that treaty was only concluded last March 2006, and only one country has joined the treaty: Singapore. They hosted the diplomatic conference. We view the Singapore Treaty as providing significant advantages relative to the underlying trademark law treaty of 1994. We expect a number of the signatories to that agreement to sign on. And, again, it is our belief that a number of our major and minor trading parties will join each of these treaties once we do.

Thank you.

Senator MENENDEZ. Let me ask you this. What are some of the most significant barriers that we still find as it relates to promoting the protection of intellectual property throughout the world today? And is WIPO moving us toward meeting those challenges? Are we meeting those challenges? And if so, how?

Ms. BOLAND. Thank you, again.

In terms of barriers to protection, I think that I'd like to look at that, as you said, in two parts. Domestically, the United States Patent and Trademark Office is very, very much involved with rightholders in the United States and other government agencies. We're involved in a very large educational program for independent inventors, small businesses, creators, and innovators throughout the entire country, to provide them with the information they need to protect their intellectual property, both in the United States and internationally. Some of these efforts are part of our STOP effort, which is an interagency effort—the acronym stands for Strategy Targeting Organized Piracy. We think that we have done a good job with these programs, and there are many other initiatives within the STOP initiative that basically encourages businesses to integrate IP into their business strategy from the beginning.

For our businesses and our American companies, I think we've done a pretty good job. Internationally, it's a bit more of a challenge. We have worked very closely with some of the more progressive voices in Asia on IP issues and IP enforcement. Obviously, Japan has got a lot at stake. We've worked very closely with them on many of the issues that we commonly face in Asia. We've also worked very, very closely with the European Union on initiatives within Europe, in terms of what's at stake there.

Turning to WIPO, unfortunately there are many voices throughout the world that are challenging our assumptions about the value of IP and its relationship to economic and technological growth. We have been fighting a number of battles at WIPO in Geneva, basically just holding back the voices of opposition to the promotion and enhancement of IP protection throughout the world. There is not much going on, in terms of further norm-setting at WIPO right now, but we are—have been very actively involved in all of the various committees there, and we are trying to hold back the forces—the anti-IP forces that we confront at WIPO.

Senator MENENDEZ. So, it sounds like we're in a defensive posture.

Ms. BOLAND. Unfortunately, that is the case for much of the discussion that takes place at WIPO right now, yes.

Senator MENENDEZ. Well, this is one of the most significant things, I think, for the United States, obviously, in a world in which we are challenged for human capital by the vast changes in technology that have largely erased the boundaries of mankind. It seems that, for the United States, intellectual property is going to be the single-biggest asset that it's going to have to preserve, protect, and defend in world trade. And I hope we're going to be robust about it. I'm sure the subcommittee that I chair is going to be looking at that quite significantly in the days ahead.

Last, I just want to ask you one final question. A lot of these treaties talk about moving toward electronic filing. And, I'm wondering, do we anticipate a time in which we would only accept trademark filings through an electronic platform? And, if so, what do we foresee that timeframe being?

Ms. BOLAND. Thank you. In terms of electronic filing in the trademark world, the USPTO can report a great success there. As of our latest stats on electronic filing for trademark applications, we have about 96 percent of applications coming in the door electronically. That's a great success. This recent Singapore Trademark Law Treaty provides us with the capability of mandating electronic filing only. It doesn't require us to do that, but it provides us with that ability. At the present time, we do not plan to mandate electronic filing only. It may be something that we'll reconsider 5 or 10 years down the road, but we think that the level of electronic filing in the area of trademarks is almost as high as it can possibly be, and that the small percentage that are coming in on paper is very manageable for the USPTO.

In the area of patents, we've made a big push for electronic filing over the last several years, and we had been able to get the percentage up to—about 48 percent of applications coming in the door are now filed electronically. We hope for further improvements as time goes on. But, again, in terms of the PLT it has similar ability to mandate electronic filing. Our current thinking is not to adopt that at the current time, but we may revisit it at some point in the future.

Senator MENENDEZ. Is it that you seek not to adopt it because it's such a small percent, on the one case, or is it simply because you don't have the ability to do that in a reasonable timeframe?

Ms. BOLAND. No; in the area of patents, I think it's a matter of coming up with an electronic filing solution that is finally starting to show very significant numbers. And I think that there will always be some segment of the filing population that may not have the capability to electronically file. We would have to come up with a mechanism to accommodate that for them. I'm thinking of, perhaps, independent inventors; some small businesses may not have that capability. So, we have to deal with that policy decision within the office, of mandating electronic filing and then going ahead and making some accommodations for those that do not have that capability.

Thank you.

Senator MENENDEZ. All right.

And, Mr. Scholz, I don't want you to feel lonely there, after all this time. I just have two questions for you. What prompted this

particular negotiation for this Protocol, with the Danish proposal? And who benefits, in terms of U.S. business?

Mr. SCHOLZ. Thank you, Mr. Chairman.

The rationale behind the amendment was that most of our post-World War II FCN treaties do include this provision. There are a few treaties that do not. The others that come to mind are Ireland, Finland, Greece, and Israel. And, in researching the issue, we've been unable to determine precisely why the decision was made not to include this provision at the time the treaty was negotiated in 1951. But, since then, there has been interest on the part of the Danes in including the provision in the treaty, as we did earlier with Finland and Ireland, and we decided to negotiate a protocol that would provide for visa eligibility for E–2 visas at that time.

In terms of the businesses that would benefit from that here in the United States, I'm not really in a position to speak to specific companies in that regard. I noted, generally, that——

Senator MENENDEZ. I meant sectors, not specific——

Mr. SCHOLZ. Oh, sectors.

Senator MENENDEZ. Yes.

Mr. SCHOLZ. Well, primarily, most Danish investment in the United States is in the manufacturing sector. I could give you a few examples of investments. I think that, in Colorado, there's a facility that produces wind turbines for wind energy generation. There are—there's some biotechnology investment, as well. I think, even in New Jersey, there is a Danish company involved in pharmaceuticals. But it's generally in the manufacturing sector.

Senator MENENDEZ. How about the dairy sector?

Mr. SCHOLZ. I'm not aware of a specific investment, at this time, in the dairy sector.

Senator MENENDEZ. OK.

And one last question. Is the Government of Denmark providing temporary visas, at this point, to United States investors?

Mr. SCHOLZ. Yes; they do. They——

Senator MENENDEZ. They do.

Mr. SCHOLZ. Without the entry into force of this protocol, they are providing access to U.S. investors. U.S. investors can get a residency permit for a year. That's extendable for another year. And, after that period, they can get even longer extensions.

Senator MENENDEZ. All right. Well, thank you. Thank you, to all of you, for your information and your testimonies. We're going to keep the record open for 2 days, should any Senator wish to submit questions for the record. If they do, we ask you to respond to it expeditiously.

We thank you for your testimony. And we'll excuse this panel.

Let me introduce and ask our next panel to begin to come forward. For our second panel, we want to welcome Mr. Bill Reinsch, the president of the National Foreign Trade Council; Ms. Janice Lucchesi, who is the vice president of tax at Akzo Nobel and chairman of the Organization for International Investment.

We look forward to your insights. Let me assure you that your full statement will be entered into the record, and we'd ask you to summarize your statement in approximately 5 minutes.

Mr. Reinsch.

STATEMENT OF HON. WILLIAM A. REINSCH, PRESIDENT, NATIONAL FOREIGN TRADE COUNCIL, WASHINGTON, DC

Mr. REINSCH. Thank you, Mr. Chairman.

The National Foreign Trade Council appreciates the chairman's action in scheduling this hearing, and we strongly urge the committee to reaffirm the United States historic opposition to double taxation by giving its full support to the pending tax treaty protocol agreements with Germany, Finland, Denmark, and the Belgium tax treaty and protocol.

The NFTC, organized in 1914, is an association of some 300 U.S. businesses engaged in international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial, and service activities, and we seek to foster an environment in which U.S. companies can be dynamic and effective competitors in the international business arena. To achieve this goal, American businesses must be able to participate fully in business activities throughout the world through the export of goods, services, technology, and entertainment, and through direct investment in facilities abroad. As global competition grows ever more intense, it is vital to the health of U.S. enterprises that they be free from excessive foreign taxes or double taxation and impediments to the flow of capital that can serve as barriers to full participation in the international marketplace. Foreign trade is fundamental to the economic growth of U.S. companies. Tax treaties are a crucial component of the framework that is necessary to allow that growth. That is why we have long supported the expansion and strengthening of the U.S. tax treaty network and why we are here to recommend the ratification of the tax protocols and treaties that are before you.

While we are not aware of any opposition to the treaties under consideration, the NFTC, as a general cautionary note, urges the committee to reject any opposition to the agreements based on the presence or absence of a single provision. No process as complex as the negotiation of a full-scale tax treaty will be able to produce an agreement that will completely satisfy every possible constituency, and no such result should be expected. Tax treaty relationships arise from delicate negotiations aimed at resolving conflicts between the tax laws and policies of the negotiating countries. The resulting compromises always reflect a series of concessions by both countries from their preferred positions. Recognizing this, but also cognizant of the vital role tax treaties play in creating a level playing field, where enterprise is engaged in international commerce, the NFTC believes that treaties should be evaluated on the basis of their overall effect. In other words, agreements should be judged on whether they encourage international trade and investment between the United States and another country. An agreement that meets this standard will provide the guidance enterprises need in planning for the future, provide nondiscriminatory treatment for U.S. traders and investors, and meet an appropriate level of acceptability in comparison with the preferred U.S. position and express goals of the business community.

We want to emphasize how important treaties are in creating, implementing, and preserving an international consensus on avoiding double taxation, particularly with respect to transactions between related entities. The tax laws in most countries impose with-

holding taxes, frequently at high rates, on payments of dividends, interest, and royalties to foreigners and treaties are the mechanism by which these taxes are lowered, on a bilateral basis.

If U.S. enterprises cannot enjoy the reduced foreign withholding rates offered by a tax treaty, noncreditable high levels of foreign withholding tax leave them at a competitive disadvantage relative to traders and investors from other countries that do enjoy the treaty benefits of reduced withholding taxes. Tax treaties serve to prevent this barrier to U.S. participation in international commerce.

If U.S. businesses are going to maintain a competitive position around the world, we need a tax treaty policy that protects them from multiple or excessive levels of foreign tax on cross-border investments, particularly if their competitors already enjoy such protection. The United States has lagged behind other developed countries in eliminating this withholding tax and leveling the playing field for cross-border investment.

The NFTC has consistently urged adjustment of U.S. tax treaty policies to allow for a zero withholding rate on related-entity dividends, and we congratulate the Treasury for making further progress in these protocols in the treaty. These agreements make an important contribution toward improving the economic competitiveness of U.S. companies. Indeed, the protocols bolster and improve upon the standards set in the United Kingdom, Australia, and Mexican agreements ratified just over 2 years ago, as well as the more recent Japanese tax treaty.

We thank the committee for its prior support of this evolution in U.S. tax treaty policy, and we strongly urge you to continue that support by ratifying all four of these treaties and protocols.

The existence of a withholding tax on cross-border patent—parent subsidiary dividends, even at the 5-percent rate previously typical in U.S. treaties, has served as a tariff-like impediment to cross-border investment flows. These withholding taxes are imposed in addition to the income taxes already paid, and often result in a lower return compared to the comparable investment of a foreign competitor. Tax treaties are designed to prevent this distortion in the investment decisionmaking process by reducing the multiple taxation of profits within a corporate group, and they serve to prevent the hurdle to U.S. participation in international commerce. Eliminating the withholding tax on cross-border dividends means that U.S. companies with stakes in German, Finish, Danish, and Belgian companies will now be able to meet their foreign competitors on a level playing field.

The German protocol provides for mandatory arbitration of certain cases that cannot be resolved by the competent authorities within a specified period of time. This provision is the first of its kind in a U.S. tax treaty. The provision is limited in its scope with respect to the cases eligible for mandatory arbitration. The Belgium tax treaty includes a more broadly defined mandatory arbitration provision. The Belgium treaty provision covers all cases where the competent authorities cannot reach agreement.

NFTC member companies review tax treaty arbitration as a tool to strengthen, not replace, the existing treaty dispute resolution procedures conducted by the competent authorities. The existing

procedures work well to resolve the great majority of disputes with a great majority of treaty partners, but they are not always adequate to address the most problematic cases and relationships.

We commend the ongoing efforts of the IRS to refine and improve the operation of the competent-authority process under treaties to make it a more efficient and reliable means of avoiding double taxation. The inclusion of the arbitration provisions in the German tax protocol and the Belgium tax treaty will greatly facilitate the mutual agreement procedures in all competent authority cases.

Finally, Mr. Chairman, we are grateful to you and to the members of the committee for giving international economic relations prominence in the committee's agenda, particularly when the demands upon the committee's time are so pressing. We would also like to express our appreciation for the efforts of both majority and minority staff which have enabled this hearing to be held at this time. We commend the committee for its commitment to proceed with ratification of these agreements as expeditiously as possible.

Thank you.

[The prepared statement of Hon. Reinsch follows:]

PREPARED STATEMENT OF HON. WILLIAM A. REINSCH, PRESIDENT, NATIONAL FOREIGN TRADE COUNCIL, WASHINGTON, DC

Mr. Chairman and members of the committee, the National Foreign Trade Council (NFTC) is pleased to recommend ratification of the treaties and protocols under consideration by the committee today. We appreciate the chairman's actions in scheduling this hearing, and we strongly urge the committee to reaffirm the United States historic opposition to double taxation by giving its full support to the pending tax treaty protocol agreements with Germany, Finland, and Denmark, and the Belgium tax treaty and protocol.

The NFTC, organized in 1914, is an association of some 300 U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial, and service activities, and we seek to foster an environment in which U.S. companies can be dynamic and effective competitors in the international business arena. To achieve this goal, American businesses must be able to participate fully in business activities throughout the world through the export of goods, services, technology, and entertainment, and through direct investment in facilities abroad. As global competition grows ever more intense, it is vital to the health of U.S. enterprises and to their continuing ability to contribute to the U.S. economy that they be free from excessive foreign taxes or double taxation and impediments to the flow of capital that can serve as barriers to full participation in the international marketplace. Foreign trade is fundamental to the economic growth of U.S. companies. Tax treaties are a crucial component of the framework that is necessary to allow that growth and balanced competition.

This is why the NFTC has long supported the expansion and strengthening of the U.S. tax treaty network and why we are here today to recommend ratification of the tax protocols with Germany, Finland, Denmark, and the tax treaty and protocol with Belgium.

GENERAL COMMENTS ON TAX TREATY POLICY

While we are not aware of any opposition to the treaties under consideration, the NFTC, as it has done in the past as a general cautionary note, urges the committee to reject any opposition to the agreements based on the presence or absence of a single provision. No process as complex as the negotiation of a full-scale tax treaty will be able to produce an agreement that will completely satisfy every possible constituency, and no such result should be expected. Tax treaty relationships arise from difficult and sometimes delicate negotiations aimed at resolving conflicts between the tax laws and policies of the negotiating countries. The resulting compromises always reflect a series of concessions by both countries from their preferred positions. Recognizing this, but also cognizant of the vital role tax treaties play in creating a level playing field for enterprises engaged in international commerce, the NFTC believes that treaties should be evaluated on the basis of their overall effect.

In other words, agreements should be judged on whether they encourage international flows of trade and investment between the United States and the other country. An agreement that meets this standard will provide the guidance enterprises need in planning for the future, provide nondiscriminatory treatment for U.S. traders and investors as compared to those of other countries, and meet an appropriate level of acceptability in comparison with the preferred U.S. position and expressed goals of the business community.

Comparisons of a particular treaty's provisions with the U.S. model or with other treaties do not provide an appropriate basis for analyzing a treaty's value. U.S. negotiators are to be applauded for achieving agreements that reflect as well as these treaties do the U.S. model and the views of the U.S. business community.

The NFTC wishes to emphasize how important treaties are in creating, implementing, and preserving an international consensus on the desirability of avoiding double taxation, particularly with respect to transactions between related entities. The tax laws of most countries impose withholding taxes, frequently at high rates, on payments of dividends, interest, and royalties to foreigners, and treaties are the mechanism by which these taxes are lowered on a bilateral basis. If U.S. enterprises cannot enjoy the reduced foreign withholding rates offered by a tax treaty, noncreditable high levels of foreign withholding tax leave them at a competitive disadvantage relative to traders and investors from other countries that do enjoy the treaty benefits of reduced withholding taxes. Tax treaties serve to prevent this barrier to U.S. participation in international commerce.

If U.S. businesses are going to maintain a competitive position around the world, we need a treaty policy that protects them from multiple or excessive levels of foreign tax on cross-border investments, particularly if their competitors already enjoy that advantage. The United States has lagged behind other developed countries in eliminating this withholding tax and leveling the playing field for cross-border investment. The European Union (EU) eliminated the tax on intra-EU, parent-subsidiary dividends over a decade ago, and dozens of bilateral treaties between foreign countries have also followed that route. The majority of OECD countries now have bilateral treaties in place that provide for a zero rate on parent-subsidiary dividends.

Tax treaties also provide other features that are vital to the competitive position of U.S. businesses. For example, by prescribing internationally agreed thresholds for the imposition of taxation by foreign countries on inbound investment, and by requiring foreign tax laws to be applied in a nondiscriminatory manner to U.S. enterprises, treaties offer a significant measure of certainty to potential investors. Another extremely important benefit which is available exclusively under tax treaties is the mutual agreement procedure. This bilateral administrative mechanism avoids double taxation on cross-border transactions.

The United States, together with many of its treaty partners, has worked long and hard through the OECD and other fora to promote acceptance of the arm's-length standard for pricing transactions between related parties. The worldwide acceptance of this standard, which is reflected in the intricate treaty network covering the United States and dozens of other countries, is a tribute to governments' commitment to prevent conflicting income measurements from leading to double taxation and resulting distortions and barriers for healthy international trade. Treaties are a crucial element in achieving this goal, because they contain an expression of both governments' commitment to the arm's length standard and provide the only available bilateral mechanism, the competent authority procedure, to resolve any disputes about the application of the standard in practice.

We recognize that determination of the appropriate arm's-length transfer price for the exchange of goods and services between related entities is sometimes a complex task that can lead to good faith disagreements between well-intentioned parties. Nevertheless, the points of international agreement on the governing principles far outnumber any points of disagreement. Indeed, after decades of close examination, governments around the world agree that the arm's length principle is the best available standard for determining the appropriate transfer price, because of both its economic neutrality and its ability to be applied by taxpayers and revenue authorities alike.

The NFTC strongly supports the efforts of the Internal Revenue Service and the Treasury to promote continuing international consensus on the appropriate transfer pricing standards, as well as innovative procedures for implementing that consensus. We applaud the continued growth of the APA program, which is designed to achieve agreement between taxpayers and revenue authorities on the proper pricing methodology to be used, before disputes arise. We commend the ongoing efforts of the IRS to refine and improve the operation of the competent authority process

under treaties, to make it a more efficient and reliable means of avoiding double taxation.

The NFTC also wishes to reaffirm its support for the existing procedure by which Treasury consults on a regular basis with this committee, the tax-writing committees, and the appropriate congressional staffs concerning tax treaty issues and negotiations and the interaction between treaties and developing tax legislation. We encourage all participants in such consultations to give them a high priority. We also commend this committee for scheduling tax treaty hearings so soon after receiving the agreements from the executive branch. Doing so enables improvements in the treaty network to enter into effect as quickly as possible.

We would also like to reaffirm our view, frequently voiced in the past, that Congress should avoid occasions of overriding the U.S. tax treaty commitments that are approved by this committee by subsequent domestic legislation. We believe that consultation, negotiation, and mutual agreement upon changes, rather than unilateral legislative abrogation of treaty commitments, better supports the mutual goals of treaty partners.

AGREEMENTS BEFORE THE COMMITTEE

The German, Finnish, and Danish protocols, and the Belgian tax treaty that are before the committee today update agreements between the United States and these countries that were signed many years ago. The protocols improve conventions that have stimulated increased investment, greater transparency, and a stronger economic relationship between our countries.

The NFTC has consistently urged adjustment of U.S. treaty policies to allow for a zero withholding rate on related-entity dividends, and we congratulate the Treasury for making further progress in these protocols and treaty. These agreements make an important contribution toward improving the economic competitiveness of U.S. companies. Indeed, the protocols bolster and improve upon the standard set in the United Kingdom, Australian, and Mexican agreements ratified just over 2 years ago, as well as the more recent Japanese tax treaty, by lowering the ownership threshold required to receive the benefit of the zero dividend withholding rate from 100 to 80 percent. We thank the committee for its prior support of this evolution in U.S. tax treaty policy and we strongly urge you to continue that support by approving all four of these tax treaties and protocols.

The existence of a withholding tax on cross-border, parent-subsidiary dividends, even at the 5-percent rate previously typical in U.S. treaties, has served as a tariff-like impediment to cross-border investment flows. These withholding taxes are imposed in addition to the income taxes already paid and often result in a lower return compared to the comparable investment of a foreign competitor. Tax treaties are designed to prevent this distortion in the investment decisionmaking process by reducing the multiple taxation of profits within a corporate group, and they serve to prevent the hurdle to U.S. participation in international commerce. Eliminating the withholding tax on cross-border dividends means that U.S. companies with stakes in German, Finnish, Danish, and Belgian companies will now be able to meet their foreign competitors on a level playing field. The German protocol would apply with respect to withholding taxes paid or credited on or after January 1 of the year in which the protocol comes into force. The other three protocols are effective upon ratification.

Additionally, important safeguards included in these protocols prevent "treaty shopping." In order to qualify for the lowered rates specified by the treaties, companies must meet certain requirements so that foreigners whose governments have not negotiated a tax treaty with Germany, Finland, Denmark, Belgium, or the United States cannot free-ride on this treaty. Similarly, provisions in the sections on dividends, interest, and royalties prevent arrangements by which a U.S. company is used as a conduit to do the same. Extensive provisions in the treaties are intended to ensure that the benefits of the treaty accrue only to those for which they are intended. All four of the tax treaties and protocols contain good limitations on benefits provision.

The German protocol provides for mandatory arbitration of certain cases that cannot be resolved by the competent authorities within a specified period of time. This provision is the first of its kind in a U.S. tax treaty. The provision is limited in its scope with respect to the cases eligible for mandatory arbitration. The Belgium tax treaty includes a more broadly defined mandatory arbitration provision. The Belgium treaty provision covers all cases where the competent authorities cannot reach agreement. NFTC member companies view tax treaty arbitration as a tool to strengthen, not replace, the existing treaty dispute resolution procedures conducted by the competent authorities. The existing procedures work well to resolve the great

majority of disputes with the great majority of treaty partners, but they are not always adequate to address the most problematic cases and relationships. The inclusion of the arbitration provisions in the German tax protocol and the Belgium tax treaty will greatly facilitate the mutual agreement procedures in all competent authority cases.

IN CONCLUSION

Finally, the NFTC is grateful to the chairman and the members of the committee for giving international economic relations prominence in the committee's agenda, particularly when the demands upon the committee's time are so pressing. We would also like to express our appreciation for the efforts of both majority and minority staff which have enabled this hearing to be held at this time.

We commend the committee for its commitment to proceed with ratification of these important agreements as expeditiously as possible.

Senator MENENDEZ. Thank you. Ms. Lucchesi.

STATEMENT OF JANICE LUCCHESI, CHAIRWOMAN, ORGANIZATION FOR INTERNATIONAL INVESTMENT, WASHINGTON, DC

Ms. LUCCHESI. Thank you for the opportunity to appear before you today to support, on behalf of the Organization for International Investment, or OFII, prompt ratification of the proposed protocols to the United States income tax treaties with Germany, Denmark, and Finland, and the new proposed income tax treaty with Belgium, all pending before the committee.

OFII is an association representing the interest of U.S. subsidiaries of companies based abroad, which I will refer to as "insourcing companies."

OFII has over 160 member companies, which range from midsized businesses to some of the largest employers in the United States, such as Honda, HSBC, Sony, AEGON Insurance, Nestle, Unilever, and L'Oreal.

Collectively, insourcing companies employ over 5 million Americans, pay 32 percent higher compensation than all U.S. firms, support 19 percent of all U.S. exports, and, in 2006, reinvested $80 billion in profits back into the U.S. economy.

For both foreign and U.S. multinationals, income tax treaties such as the agreements before you today promote business and employment opportunities in each country, protect against discrimination, provide a common and consistent set of rules aimed at fair taxation, as well as provide a mechanism for eliminating the potential for double taxation. The prompt ratification of these agreements will signal to insourcing companies that their continued investment in job creation in the United States is to be encouraged.

The U.S. Treasury Department is to be commended for its dedication and drive to maintain and expand our network of bilateral income tax treaties with our major trading partners, and assuring that these agreements remain current and relevant in an ever changing global fiscal and economic environment.

The agreements pending before you today contain important improvements over our current income tax treaties with Belgium, Denmark, Finland, and Germany, reflecting the most current United States international tax policies.

Beginning with the 2001 new income tax convention with the United Kingdom, the United States has advanced a policy of eliminating the withholding tax on direct investment dividends. The four agreements before you today are a further and meaningful

step in extending that policy to most of the United States major European trading partners.

Elimination of the withholding tax removes a significant impediment to direct foreign investment. It also assures that United States corporations receive the same benefit from dividends paid by their subsidiaries in Europe as European corporations receive from dividends paid by their subsidiaries throughout Europe.

The agreements with Germany and Belgium also make significant strides in addressing potential inefficiencies when employees are on assignment away from their home country, assuring that pension benefits are preserved and the tax treatment of contributions to, income earned by, and payments from, pension plans are not distorted by reason of employee transfers abroad.

Finally, we welcome and endorse a provision reflected in the agreements with Germany and Belgium, the addition of arbitration as a means of improving the dispute resolution process. Tax treaties cannot resolve every instance of potential double taxation. In recognition of this, our treaties have consistently included a mutual agreement article allowing taxpayers to request that, where the actions of one or both tax authorities results, or could result, in double taxation, the two authorities meet, with a view to eliminating potential double taxation.

This mechanism most commonly comes into play in the area of transfer pricing. The United States experience resolving in—with resolving these double taxation disputes under the mutual agreement article has been mixed. The process is often lengthy and expensive, and the tax authorities may have basic differences that impede agreement. The United States has been a leader in this dispute resolution process, and would greatly benefit from a more disciplined approach.

A process that provides for submission of specific issues to binding arbitration if the two tax authorities are not able to resolve the matter within a reasonable period would be a welcome improvement to the bilateral dispute resolution process.

In conclusion, OFII appreciates this opportunity to register its strong support for the agreements pending before your committee today. I thank the committee for this opportunity to provide this input, and am happy to answer any questions you may have.

[The prepared statement of Ms. Lucchesi follows:]

PREPARED STATEMENT OF JANICE LUCCHESI, CHAIRWOMAN OF THE BOARD, ORGANIZATION FOR INTERNATIONAL INVESTMENT (OFII), WASHINGTON, DC

Mr. Chairman, ranking member and members of the committee, thank you for the opportunity to appear before you today to support, on behalf of the Organization for International Investment ("OFII"), prompt ratification of the proposed protocols to the United States income tax treaties with Germany, Denmark, and Finland, and the new proposed income tax treaty with Belgium, all pending before this committee.

OFII is an association representing the interests of U.S. subsidiaries of companies based abroad which I will refer to as "insourcing" companies. OFII has over 160 member companies, which range from mid-sized businesses to some of the largest employers in the United States, such as Honda, HSBC, Sony, AEGON Insurance, Nestlé, Unilever, and L'Oreal.

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For both foreign and U.S. multinationals, income tax treaties, such as the agreements before you today, promote business and employment opportunities in each country, protect against discrimination, provide a common and consistent set of rules aimed at fair taxation, as well as provide a mechanism for eliminating the potential for double taxation. The prompt ratification of these agreements will signal to insourcing companies that their continued investment and job creation in the United States is to be encouraged.

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Beginning with the 2001 new income tax convention with the United Kingdom, the United States has advanced a policy of eliminating the withholding tax on direct investment dividends. The four agreements before you today are a further and meaningful step in extending that policy to most of the United States major European trading partners. Elimination of the withholding tax removes a significant impediment to direct foreign investment. It also assures that United States corporations receive the same benefit from dividends paid by their subsidiaries in Europe as European corporations receive from dividends paid by their subsidiaries throughout Europe.

The agreements with Germany and Belgium also make significant strides in addressing potential inefficiencies when employees are on assignment away from their home country, assuring that pension benefits are preserved and the tax treatment of contributions to, income earned by, and payments from, pension plans are not distorted by reason of employee transfers abroad.

Finally, we welcome and endorse a provision reflected in the agreements with Germany and Belgium—the addition of arbitration as a means of improving the dispute resolution process. Tax treaties cannot resolve every instance of potential double taxation. In recognition of this, our treaties have consistently included a "Mutual Agreement" article allowing taxpayers to request that, where the action of one or both tax authorities results or could result in double taxation, the two tax authorities meet with a view to eliminating the potential double taxation. This mechanism most commonly comes into play in the area of transfer pricing. The United States experience with resolving these double taxation disputes under the Mutual Agreement article has been mixed. The process is often lengthy and expensive and the tax authorities may have basic differences that impede agreement. The United States has been a leader in this dispute resolution process and would greatly benefit from a more disciplined approach. A process that provides for submission of specific issues to binding arbitration if the two tax authorities are not able to resolve the matter within a reasonable period would be a welcome improvement to the bilateral dispute resolution process.

In conclusion, OFII appreciates this opportunity to register its strong support for the agreements pending before your committee today.

I thank the committee for the opportunity to provide this input and am happy to answer any questions you may have.

Senator MENENDEZ. Thank you.

Let me ask both of you, are there any provisions in these agreements that would particularly be beneficial to specific U.S. industries doing businesses in these countries; in Germany, Belgium, Finland, or Denmark—that you can think of?

Ms. LUCCHESI. Specific industries?

Senator MENENDEZ. The provisions in the agreements that are going to be particularly beneficial to some specific U.S. industries.

Mr. REINSCH. Mr. Chairman, I think our answer to that question would be: No; we're not aware of any particular sector that might benefit more than another on these treaties.

Ms. LUCCHESI. Yes; I agree with him.

Senator MENENDEZ. OK. Clearly, there have been advocates for these treaties within the private sector, have there not?

Mr. REINSCH. Well, our memberships are different. Our members are, for the most part, large multinational companies with a U.S. base and U.S. headquarters. If you look at our tax committee, which is the group that does most of the work on this, it would be companies that you've heard of, like Procter & Gamble, a number of the oil companies, other manufacturers, some banks and financial services institutions, and some high-tech companies.

Senator MENENDEZ. Let me ask you this. What are some of the most significant barriers created by tax systems, that still remain, to cross-border investment?

Ms. LUCCHESI. Still remain——

Senator MENENDEZ. That still remain——

Ms. LUCCHESI [continuing]. Without the——

Senator MENENDEZ. Not in these agreements, necessarily, but in general, since we have the benefit of your expertise here, as we're looking prospectively.

Ms. LUCCHESI. I think a—the prospect of double taxation, in terms of everyday trade—so, that's in transfer price—there is not an agreement among our major trading partners on exactly what is a fair transfer price. So, in my experience, we've spent a lot of time in discussions with various tax authorities over, "What was the price that the U.S. company should have charged a European country for a good?" and vice versa.

Mr. REINSCH. I think, in our case I'd certainly agree with that. Our members have focused, also, on countries with whom we don't have either up-to-date or any tax treaties, and there are some rather significant economies, most notably Canada and Brazil, with whom we don't have tax treaties, and we are very anxious to see this kind of process put into place with respect to them. There have been negotiations going on with the Canadians that I believe are nearly complete, and I hope you'll be presented with that document soon. That would be good news.

Senator MENENDEZ. I was just going to ask you: Are we on the right path, in both cases, in terms of trying to address those barriers?

Mr. REINSCH. With Canada, we are very much on the right path, and I hope it will be submitted to the Senate soon.

With Brazil, I can report, based only on the last 4 or 5 months, that I think we are now on an appropriate path. The Brazilian Government has reflected, recently—meaning in the spring of this year—a much stronger interest in negotiating an agreement than they have in the past. And they've done so, in part, because they have a number of Brazilian companies that are very interested in having the treaty as well, so it makes the interest bilateral, rather than unilateral.

Senator MENENDEZ. How significant is the arbitration provisions that you've both cited in your testimony? Are they precedent-setting? Are they something we're going to likely look forward to seeing in other agreements? Is it something that we want to see in other agreements?

Mr. REINSCH. I would hope that they would be precedent-setting; and we would like to see them in other agreements. I think, in general, to save the committee's time, I would subscribe, for the most part, to Mr. Harrington's——

Senator MENENDEZ. At this——

Mr. REINSCH [continuing]. Analysis.

Senator MENENDEZ [continuing]. Point, you're just saving my time.

Mr. REINSCH. Well, I——

[Laughter.]

Mr. REINSCH [continuing]. I was trying to generalize.

Senator MENENDEZ. And I'm asking the questions, so don't hesitate to give me a full answer.

Mr. REINSCH. I think I would subscribe largely to Mr. Harrington's analysis, Mr. Chairman. We don't see them as being frequently invoked. We see their existence as an incentive to the competent authorities to work things out. We are, in general, happy with the competent-authority process. There have been, and occasionally are—it varies over time and by individual country—cases where the competent-authority process is either prolonged or doesn't produce a resolution. We think having the arbitration process, if you will, hanging over their heads will lead to better—and more efficient—competent-authority work, which is a fine outcome. And, failing that, the arbitration process is also a fine outcome, from our point of view.

Ms. LUCCHESI. Yes. I concur. It certainly adds to certainty. In an area where there aren't many certainties, this is going to reduce some element of the risk of double taxation.

Senator MENENDEZ. Let me pick your brain about the question I asked earlier about—prospectively—about the taxpayer participation. How do you view that?

Mr. REINSCH. I was thinking about that as you raised it, Mr. Chairman. It's a novel thought. I think the idea to my companies that they might have some influence with the tax authorities is one that I'm sure they'll want to give some thought to. It's kind of a new idea.

I am advised that right now they are, in general, satisfied with the relationship they have with the U.S. competent authority, and are satisfied that their point of view is taken into account and considered as part of the process now. So, they don't feel alienated or separated from the process now, even though they are not, as you pointed out, precisely part of it.

That said, I think that there might be something to be said, prospectively, for looking at that question, and I'd be pleased to go back to my members and then report the results to the committee staff for your consideration.

Senator MENENDEZ. I'd love to hear their response to that. Seems to me that formalizing their participation guarantees that the competent authority will take their views and concerns as a essential part of the process, versus the possibility of it. Anyhow, we'd love to hear the response.

And, last, are there any provisions or changes that the updated treaties before us today do not include that you think, moving forward,, subject to the call of the Chair.]should be considered as we look, prospectively?

Mr. REINSCH. The——

Senator MENENDEZ. If you had a magic wand?

Mr. REINSCH. Well, they're all different, and—I'm not the best person to get into the weeds, although we would be happy to get into the weeds later on, if you'd like—I think, in general, we're satisfied with these, certainly. The provision I could simply flag is—that has historically been the most important to my members—has been the zero withholding provision, which is why we are particularly supportive of these treaties. To the extent that that could be obtained in future treaties, and that it could be obtained as broadly as possible, we would be even more enthusiastic.

Ms. LUCCHESI. There is—there's a provision that's in the German and Belgium treaties that is not in the other two and is not in many of our other treaties, relating to pension benefits, where both of the—both the United States and Germany and Belgium agree that they will not tax the pension earnings of the—that the U.S. national might make when he's overseas and remains a part of the U.S. pension plan, and vice versa. And they explicitly state that certain pension plans will be deemed to be acceptable plans, so there's no need to go to competent authority to get your pension plan blessed, there's just a per se list of acceptable pension plans. And, from a company that wants to transfer employees throughout the world, this is critical, because it is—obviously, in the end, it is the company that's going to pay the tax cost. If I remain in my U.S. pension plan and transfer to the Netherlands, that's a—and the United States taxes the—my earnings—and the Netherlands taxes my earnings, obviously my company is going to pay for that. So, these—the German and Belgium treaties are really to be applauded for containing this provision, and we would love to see that in other treaties, as well.

Senator MENENDEZ. Well, thank you for your testimony.

Seeing no other member of the committee, the record will remain open for 2 days so that committee members may submit additional questions to the witnesses. I ask if that you, in fact, receive such questions, that you respond to them expeditiously.

Senator MENENDEZ. If no one has any additional comments, the hearing is adjourned.

[Whereupon, at 4:22 p.m., the hearing was adjourned.]

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

PREPARED STATEMENT OF ALAN C. DREWSEN, EXECUTIVE DIRECTOR, INTERNATIONAL TRADEMARK ASSOCIATION, NEW YORK, NY

Mr. Chairman, the International Trademark Association (INTA) appreciates this opportunity to express its views on the Singapore Treaty on the Law of Trademarks which replaces the Trademark Law Treaty of 1994 to which the United States is a signatory. On behalf of our members, we respectfully ask the committee to give this revision of the World Intellectual Property Organization Trademark Law Treaty of 1994 its favorable consideration.

The International Trademark Association is a not-for-profit membership association of more than 5,000 trademark owners and professionals dedicated to the support and advancement of trademarks and related intellectual property ("IP") as elements of fair and effective national and international commerce. INTA works closely with government and judicial authorities around the world to promote the development and application of trademark law.

The Singapore Treaty is the product of worldwide growth in e-commerce and provides consistent rules for electronic filing of trademark applications, as well as further simplification and streamlining of administrative procedures. The modernization of the 1994 treaty reflects developments in technology and trademark practice.

INTA wishes to draw the committee's attention to the following key changes all of which constitute improvement over the 1994 treaty:

1. Creation of an Assembly

An assembly of contracting parties has been created with the power to deal with matters concerning the development of the treaty. This consists of amending the treaty regulations, including the Model International Forms and performing other functions as appropriate to implement the provisions of the treaty.

2. Trademark License Recordal Provisions

Provisions relating to trademark license recordal establish maximum requirements for the requests for recordal, amendment, or cancellation. Importantly, nonrecordal of a license shall not affect the validity of the registration of the mark which is the subject of the license or the protection of that mark. Recordal of a license may not be required as a condition for the use of a mark by a licensee to be deemed to constitute use by the holder in proceedings relating to the acquisition, maintenance, and enforcement of marks. Recordal of a license may also not be required as a condition for a licensee to join infringement proceedings initiated by the holder or to obtain infringement damages through such proceedings, although any state or intergovernmental organization may still declare through a reservation that it requires license recordal as a condition in this regard.

These provisions will simplify and reduce costs in many countries where the formalities of the recordal process are obstacles to cost-effective trademark protection. On the other hand, the treaty addresses the situation where failure to record licenses poses unacceptable risk for U.S. trademark owners.

3. Relief Measures When Time Limits Are Missed

Three possible types of relief measures are provided in cases in which a time limit has been missed for an action in a procedure relating to an application or registration. These include: (i) Extension of the time limit; (ii) continued processing; and (iii) reinstatement of rights if the trademark office finds that the failure to meet the time limit occurred despite due care taken, or if the failure was unintentional.

4. Electronic Communications

In response to the increasing automation and adoption of electronic filing systems by trademark offices since 1994, the Singapore Treaty allows contracting parties to choose the means of transmittal of communications and to determine if they will accept paper, electronic, or other forms of communications. This is an especially important matter for the U.S. Patent and Trademark Office (PTO), which has expanded its automation capacity during the filing process.

5. Expanded Scope of Marks Covered

The Singapore Treaty may be generally applied to all signs registrable under the national law of any contracting party, including nonvisible signs such as sounds and smells, in addition to nontraditional marks such as three-dimensional marks and holograms.

6. Supplementary Resolution to the Singapore Treaty

In addition to the main text and regulations to the Singapore Treaty, the diplomatic conference also adopted a supplementary resolution that states that contracting parties are not obliged to register the "new types of marks" mentioned in the regulations to the treaty, or implement electronic filing or other automated systems.

Mr. Chairman, ratification of the Singapore Treaty will improve the ability of U.S. trademark owners to protect their intellectual property throughout the world. Upon entry into force, this will simplify formal procedures and reduce associated costs for trademark applicants and governments. We urge the committee to report the Singapore Treaty favorably.

LETTER SUBMITTED AS A PREPARED STATEMENT OF THE AMERICAN INTELLECTUAL PROPERTY LAW ASSOCIATION (AIPLA), ARLINGTON, VA

AIPLA,
Arlington, VA, July 23, 2007.

Hon. JOSEPH R. BIDEN, Jr.,
Chairman, Committee on Foreign Relations,
U.S. Senate, Dirksen Senate Office Building, Washington, DC.

DEAR MR. CHAIRMAN: The American Intellectual Property Law Association (AIPLA) is pleased to present its views on the Singapore Treaty on the Law of Trademarks adopted on March 28, 2006, in Singapore, the Geneva Act of the Hague Agreement Concerning the International Registration of Industrial Designs adopted on July 2, 1999, in Geneva, and the Patent Law Treaty and Regulations Under the Patent Law Treaty adopted on June 1, 2000, in Geneva.

AIPLA is a national bar association of more than 16,000 members engaged in private and corporate practice, in government service, and in the academic community. AIPLA represents a diverse spectrum of individuals, companies, and institutions involved directly or indirectly in the practice of patent, trademark, copyright, and unfair competition law, as well as other fields of law affecting intellectual property. Our members represent both owners and users of intellectual property.

The treaties captioned above concern three discrete aspects of intellectual property law: Trademarks, industrial designs, and patents. All three treaties, however, recognize the need to streamline the protection of intellectual property rights and to remove legal complexity and procedural difficulty in obtaining and maintaining such rights. To the extent those goals may be accomplished should the United States adhere to these treaties, all rights holders, and in particular small entities in the United States, will be better able to participate in the growing global economy with sound, cost-effective intellectual property protection.

We note that, while all three of the above referenced treaties have been referred to the Senate for its advice and consent, no implementing legislation has been published. In the case of the Singapore Treaty, we believe that the United States currently complies with the treaty provisions and that no implementing legislation would be required to implement it. Regarding the two Geneva treaties, however, implementing legislation would be required and, while we are able to offer our general views on these treaties, we must reserve final judgment until we are able to review the specific proposed implementing legislation.

SINGAPORE TREATY ON THE LAW OF TRADEMARKS

The Singapore Treaty on the Law of Trademarks (the Singapore Treaty) was adopted in Singapore on March 28, 2006, and forwarded to the Senate for its advice and consent on May 3, 2007. Ratification and implementation of this treaty will significantly benefit U.S. trademark owners conducting business globally. We, therefore, urge the committee to support ratification of the Singapore Treaty.

The Singapore Treaty builds upon and updates the Trademark Law Treaty of 1994, to which the United States is a party. The 1994 treaty harmonized formalities and simplified procedures in applying, registering, and renewing trademarks, by establishing maximum requirements that Contracting Parties can impose on trademark applicants and holders. The Singapore Treaty maintains this focus, but has a wider scope of application and addresses new developments in the field of communication technology.

The Singapore Treaty applies to all types of marks registrable under the law of a given Contracting Party. The treaty allows Contracting Parties the freedom to choose the means of communication with their trademark offices, and introduces relief measures for missed time limits and errors in recording trademark licenses. Other provisions of the Singapore Treaty closely follow the Trademark Law Treaty. Such common procedural standards would create a level playing field for all parties that invest in branded goods. Moreover, the Singapore Treaty creates a dynamic regulatory framework for brand rights and, unlike the Trademark Law Treaty, establishes an Assembly of the Contracting Parties that can review administrative details, a feature of great practical importance for brand owners.

The Singapore Treaty addresses the burdensome license recordal requirements in some countries that make it difficult for trademark licensors and licensees to enforce trademark rights. In many cases, failure to record a license results in invalidation of the trademark registration. The Singapore Treaty's license recordal provisions reduce the formalities that trademark owners are subject to when doing business with a Contracting Party that requires recordal, and mitigate the damaging effects that can result from failure to record a license in those jurisdictions.

Unlike the Trademark Law Treaty, the Singapore Treaty allows Contracting Parties the freedom to choose the form and means of transmittal of communications, i.e., whether they accept communications on paper, communications in electronic form, or any other mode of communication. This allows national and regional trademark offices to move to electronic systems for receiving and processing trademark applications, permitting such offices to take advantage of electronic communication systems as an efficient and cost-saving alternative to paper communications. The Singapore Treaty also maintains a very important provision of the Trademark Law Treaty, namely that the authentication, certification, or attestation of any signature on paper communications cannot be required. Contracting Parties remain free to determine whether and how they wish to implement a system of authentication of electronic communications.

The treaty protects applicants from failures to comply with time limits by requiring Contracting Parties to provide at least one of the following forms of relief: An extension of time to comply, the opportunity to continue processing, or a reinstatement of rights. Such mandatory relief would mitigate drastic penalties resulting from mere failure to meet a specific time limit.

The Singapore Treaty, in contrast to the Trademark Law Treaty, applies generally to marks that can be registered under the law of a Contracting Party. Never before have nontraditional marks been explicitly recognized in an international instrument dealing with trademark law. The treaty is applicable to all types of marks, including nontraditional visible marks such as holograms, three-dimensional marks, color, position, and movement marks, and nonvisible marks such as sound, olfactory, or taste and feel marks. The Regulations provide for the mode of representation of these marks in applications, which may include nongraphic or photographic reproductions.

The Singapore Treaty creates an Assembly of the Contracting Parties, introducing a degree of flexibility in the definition and refinement of administrative procedures to be implemented by national trademark offices. We anticipate that future developments in trademark registration procedures and practice will warrant amendment of those details. The assembly is endowed with powers to modify the Regulations and the Model International Forms, where necessary, and it can also deal—at a preliminary level—with questions relating to future development of the treaty.

As outlined above, ratification of this treaty by the United States and other nations will significantly benefit U.S. trademark owners conducting business globally. Ratification will simplify procedures for both national and regional offices and for applicants, reducing transaction costs and minimizing inadvertent loss of valuable rights.

AIPLA supports ratification by the United States of the Singapore Treaty on the Law of Trademarks.

GENEVA ACT OF THE HAGUE AGREEMENT CONCERNING THE INTERNATIONAL REGISTRATION OF INDUSTRIAL DESIGNS

The Geneva Act of the Hague Agreement (the Agreement) was adopted in Geneva on July 2, 1999, and forwarded to the Senate for its advice and consent on November 13, 2006. Ratification and implementation of this Agreement would provide industrial designers in the United States with access to an international legal framework through which they may obtain protection for their designs in multiple countries by filing a single application. We therefore urge the committee to support ratification of the Agreement.

The Hague Agreement for the International Protection of Industrial Designs (the "Hague Agreement") includes three international treaties: The London Act (1934), the Hague Act (1960), and the Geneva Act (1999). A Contracting Party may ratify any or all of the three treaties. The most recent of these, the Geneva Act, became operational on April 4, 2004. This Agreement contains provisions that meet the needs of countries, like the United States, that undertake novelty examinations of industrial designs. Many of the provisions of the Agreement were specifically negotiated to accommodate these needs, as were the Regulations and Administrative Instructions.

The primary benefit of the Agreement would be that U.S. designers could obtain multinational industrial design protection with a single application, instead of filing individual applications in each country of interest. Consequently, the Agreement is cost effective and efficient; creating opportunities that would not otherwise exist for an enterprise with a limited budget for legal protection. The Agreement, therefore, affords right holders great flexibility in targeting national, regional, or global markets for particular goods.

U.S. design owners would be able to file for design registration in any number of the Contracting Parties with a single standardized application in English. The application could be filed at either the United States Patent and Trademark Office (USPTO) or the International Bureau of the World Intellectual Property Organization (WIPO). In a similar manner, renewal of the design registration in each Contracting Party could be made by filing a single request, along with payment of the appropriate fees, with the International Bureau. The filing date of the international design application would be the date the application was received by either the International Bureau or the USPTO.

The International Bureau would normally publish the international registration within 6 months of the registration date. The international registration would have the same effect in the USPTO as a regularly filed national application under U.S. law. The international registration would be effective for a period of 5 years from the date of the registration, and could be renewed for additional 5-year terms.

The Agreement contemplates that Contracting Parties may make declarations with respect to a variety of Agreement articles. The Department of State has recommended to the Senate that United States ratification be accompanied by nine such declarations. As a whole, we believe that the advantages of the Agreement are such that they far outweigh any concerns that we have about any particular proposed declaration. We do note, however, that the eighth declaration, authorized by rule 13(4) of the Agreement, allows the USPTO to notify the WIPO Director General that the law of the United States requires a security clearance and that the prescribed 1-month period during which the patent office of a Contracting Party is required to forward an application to the International Bureau shall be replaced by a period of 6-months to provide time for a security review of the application. While we appreciate that a design application may occasionally give rise to a need for such a security review, we believe that such instances are rare and that a 6-month delay in providing the application to the International Bureau is excessive. We would prefer that the eighth declaration be withdrawn, or that the proposed 6-month delay be shortened.

As a whole, however, we believe that designers in the United States should have access to an international legal framework through which they may obtain protection for their industrial designs in multiple countries by filing a single application, and that the Agreement provides such a framework.

AIPLA supports ratification by the United States of the Geneva Act of the Hague Agreement Concerning the International Registration of Industrial Designs.

PATENT LAW TREATY AND REGULATIONS UNDER THE PATENT LAW TREATY

The Patent Law Treaty (the PLT) was adopted in Geneva on June 1, 2000, entered into force on April 28, 2005, and was forwarded to the Senate for its advice and consent on September 5, 2006. The PLT harmonizes and streamlines formal procedures in respect of national and regional patent applications and patents, reducing or eliminating formalities and potential loss of rights. Such procedural simplification can only benefit U.S. inventors. We, therefore, urge the committee to support ratification of the Patent Law Treaty.

The PLT sets forth the maximum procedural requirements that a Contracting Party may impose on patent applicants, and dictates standardized requirements for obtaining a filing date. The grant of a filing date is essential for establishing priority for the grant of a patent and for the prior art applicable for determining the patentability of an invention. It is also relevant to claiming a right of priority under the Paris Convention as well as to the calculation of the term of patent protection. The PLT sets up requirements for obtaining a filing date and procedures to avoid loss of the filing date because of a failure to comply with formal requirements. In principle, the patent office of any Contracting Party is required to accord a filing date to an application on the basis of three elements: (i) An indication that what was filed is intended to be a patent application; (ii) indications that identify the applicant and allow the applicant to be contacted; and (iii) a part that appears to be a description of the invention. No additional elements may be required to receive a filing date.

The PLT establishes a single internationally standardized set of formal requirements for national and regional applications. To avoid having international "double standards," the formal requirements in respect of international applications under the PCT are incorporated into the PLT, wherever appropriate. The PLT provides for the establishment of several Model International Forms that have to be accepted by the patent offices of all Contracting Parties. Using the Model International Forms assures applicants and other parties that no patent office may refuse the communication because of noncompliance with a formal requirement.

To reduce any unnecessary burden on applicants, the PLT provides that evidence in support of the formal contents of an application, declarations of priority, or authentication of translations may only be required where a patent office has a reasonable doubt as to the veracity of the indications or the accuracy of the translation submitted by the applicant. A Contracting Party may not require a copy or a certified copy of an earlier application if it was filed with the patent office of that Contracting Party or if it could obtain the copy or the certification from other patent offices through a digital library that is accepted for that purpose. Multinational projects are now underway to expand such digital libraries that, in combination with this treaty provision, would largely eliminate the burdensome exchange of paper certified copies of prior applications.

The PLT provides three types of relief from failure to comply with certain formal requirements. The first is an extension of procedural time limits where an applicant or owner requests the extension prior to the expiration of the time limit; the second is an extension of such time limits where an applicant or owner requests the extension after the expiration of the unobserved time limit; and the third is continued processing. A Contracting Party is not obliged to provide the first type of extension; however, it must provide either the second type of extension or continued processing. Relief under these provisions is limited to noncompliance with a time limit fixed by a patent office, not to time limits fixed by legislation. The PLT also provides safeguard provisions for situations where an applicant or owner might lose rights with respect to an application or patent for failure to meet a time limit. Reinstatement of such rights is applicable to all time limits, including time limits set by legislation. The PLT also provides for the correction and addition of priority claims and restoration of priority rights where an application is filed after the expiration of the 12-month priority period, and where an applicant cannot submit a copy of an earlier application within 16 months from the priority date because of a delay in the patent office with which the earlier application was filed.

The PLT would facilitate implementation of electronic filing of applications and other communications, to the advantage of both patent offices and their users, while ensuring the coexistence of both paper and electronic communications. Applicants would be allowed to file applications and communications on paper, at least for the purposes of acquiring a filing date and complying with a time limit.

The Department of State Letter of Submittal noted that United States law does not contain a "unity of invention" requirement, and that the USPTO advises that it considers this a substantive patent law matter that it does not recommend changing. Accordingly, the Department of State recommended that the following reservation be included in the U.S. instrument of ratification: "Pursuant to Article 23, the United States declares that Article 6(1) shall not apply to any requirement relating to unity of invention applicable under the Patent Cooperation Treaty to an international application." AIPLA strongly opposes this reservation and favors acceptance by the USPTO of the unity of invention standard as a "best practice" for all purposes, including those implicated in international applications. Ratification of the Patent Law Treaty, however, even with the proposed reservation regarding unity of invention, will streamline and harmonize formal procedures in respect of national and regional patent applications and patents.

AIPLA supports ratification by the United States of the Patent Law Treaty and Regulations under the Patent Law Treaty.

Thank you for your consideration of our views on these important treaties.

Sincerely,

MICHAEL KIRK,
Executive Director, AIPLA.

AMERICAN BAR ASSOCIATION,
SECTION OF INTELLECTUAL PROPERTY LAW,
Chicago, IL, September 6, 2007.

Hon. JOSEPH R. BIDEN, Jr.,
Chairman, Committee on Foreign Relations,
U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: I am writing to express the views of the Section of Intellectual Property Law of the American Bar Association on the Patent Law Treaty and Regulations Under Patent Law Treaty ("the Treaty"). These views have not been submitted to the ABA House of Delegates or Board of Governors, and should not be considered to be views of the Association. The Treaty was completed in Geneva on June 1, 2000. The President transmitted the treaty to the Senate on September

5, 2006, recommending that the treaty be ratified, with a reservation. (Treaty Document No.109–12) We recommend that the treaty be ratified without reservation.

The Intellectual Property Law Section of the American Bar Association is the world's largest organization of Intellectual Property Professionals with approximately 19,000 members, including lawyers, associates and law students. In recognition of the importance of patent law, the ABA established the Section in 1894 as the first ABA section to deal with a special branch of the law. This Section has contributed significantly to the development of the American system for the protection of Intellectual Property rights. The Section is composed of lawyers of diverse backgrounds who represent patent owners, accused infringers, individual inventors, large and small corporations, and universities and research institutions, all across a wide range of technologies and industries.

We understand that the Committee is currently considering ratification of the treaty, and that a hearing was held in connection with such ratification on July 17. Our Section is extremely pleased with such consideration and we encourage the Senate to proceed with such ratification.

We note that, in transmitting the treaty to the Senate, the President recommended that a reservation be taken under Article A23 of the treaty which reservation would prevent the Unity of Invention Standard as set forth in the Patent Cooperation Treaty to be applicable to national applications filed in the United States Patent and Trademark Office.

The Section of Intellectual Property Law opposes such reservation. While the United States Patent Office had previously committed itself to accept a Unity of Invention Standard and has undertaken numerous studies in that regard, thus far the office has not implemented the Unity of Invention Standard. Such Unity of Invention Standard is already effective in International applications filed with the United States Patent office, as well as in substantially all national and regional patent offices around the world. It would make prosecution of patent applications more uniform in the United States Patent Office and would reduce costs and burdens on patent applicants. We therefore encourage the Senate to ratify the Patent Law Treaty without such reservation so that the Unity of Invention Standard as set forth in the Patent Cooperation Treaty would be applicable to national applications filed in the USPTO.

We would be pleased to provide additional information in connection with the above should such be requested.

Respectfully submitted,

PAMELA BANNER KRUPKA,
Chair, Section of Intellectual Property Law,
American Bar Association.

RESPONSE OF LOIS BOLAND TO FOLLOWUP QUESTION SUBMITTED BY SENATOR BIDEN CONCERNING THE ABOVE ABA LETTER OF SEPTEMBER 6, 2007, ABOUT TREATY DOC. 109–12

QUESTION. The American Bar Association's Section of Intellectual Property Law wrote to the committee in support of U.S. ratification of the Patent Law Treaty and Regulations Under the Patent Law Treaty (the "PLT") in a letter dated September 6, 2007, but in so doing, also expressed its strong opposition to the reservation recommended by the executive branch, which is in the report on the treaty prepared by the Department of State (Treaty Doc. 109–12, p.9).

The letter states in relevant part as follows:

> We note that, in transmitting the Treaty to the Senate, the President recommended that a reservation be taken under Article 23 of the Treaty which reservation would prevent the Unity of Invention Standard as set forth in the Patent Cooperation Treaty to be applicable to national applications filed in the United States Patent and Trademark Office.
>
> The Section of Intellectual Property Law opposes such reservation. While the United States Patent Office had previously committed itself to accept a Unity of Invention Standard and has undertaken numerous studies in that regard, thus far the Office has not implemented the Unity of Invention Standard. Such Unity of Invention Standard is already effective in International applications filed with the United States Patent Office, as well as in substantially all national and regional patent offices around the world. It would make prosecution of patent applications more uniform in the United States Patent Office and would reduce costs and burdens on patent applicants. We therefore encourage the Senate to ratify the Patent Law

> Treaty without such reservation so that the Unity of Invention Standard as set forth in the Patent Cooperation Treaty would be applicable to national applications filed in the USPTO.

Please explain why, in light of these comments, this reservation is necessary. Also, please indicate whether the USPTO previously committed itself to accepting a Unity of Invention Standard, as suggested in the letter quoted above.

Answer. The proposed United States reservation under Article 23 of the Patent Law Treaty (PLT) is necessary to maintain current flexibilities in managing United States Patent and Trademark Office (USPTO) workload. If the United States were to adopt the Unity of Invention requirement right now, the rule change would necessitate an increased level of fees to cover a higher workload burden, and moreover, would lead to higher pendency rates for patent issuance.

As explained by the USPTO in a 2003 Request for Comments on the Unity of Invention standard:

> The Unity of Invention standard is a component of many foreign patent laws and is also used in international search and preliminary examination proceedings conducted pursuant to the PCT.
>
> United States restriction practice is based on 35 U.S.C. 121, which provides that: "[i]f two or more independent and distinct inventions are claimed in one application, the Director may require the application to be restricted to one of the inventions." This allows examiners to limit applicants to one set of patentably indistinct inventions per application. The USPTO may "restrict" the application to one set of patentably indistinct inventions: (1) If the application includes multiple independent and patentably distinct sets of inventions, and (2) if there is an undue burden to examine more than one invention in the same application. Restriction practice was designed to balance the interest of granting an applicant reasonable breadth of protection in a single patent against the burden on the USPTO of examining multiple inventions in a single application.
>
> Current USPTO policy allows for restriction between related inventions as well as between independent inventions. However, if the USPTO adopts a Unity of Invention standard, restriction would, as a general rule, no longer be permitted between certain related inventions that currently may be restricted under United States restriction practice. Some examples of related inventions that are often filed together and typically can be restricted under current United States practice before a prior art search is conducted, but do not lack unity under the Unity of Invention standard, include: (1) A process, and the apparatus for carrying out the process; (2) a process for making a product, and the product made; (3) an apparatus, and the product made by the apparatus; (4) a product, and the process of using the product.
>
> A lack of Unity of Invention is different from restriction practice in some major aspects. Unity of Invention is practiced, with slight variations, in PCT applications and in applications examined by the European Patent Office (EPO) and the Japan Patent Office (JPO). The primary consideration for establishing Unity of Invention is that the claims are entitled to be examined in a single application if the claims are so linked together as to form a single general inventive concept, premised on the concept of a common feature (referred to as a "special technical feature" in the context of PCT Rule 13) that can be present in multiple inventions within a single application. As long as the same or corresponding common feature is found in each claim and that common feature makes a contribution over the prior art, the claims comply with the requirement for Unity of Invention. If the inventions lack a common feature that makes a contribution over the prior art, then a holding of lack of Unity of Invention would be proper. The determination of whether an invention makes a contribution over the prior art can effectively be done only after a prior art search for the common feature has been performed.

"Request for Comments on the Study of the Changes Needed to Implement a Unity of Invention Standard in the United States," 1271 Off. Gaz. Pat. Office 98 (June 17, 2003), 68 Fed. Reg. 27536 (May 20, 2003).

The Patent Cooperation Treaty does use a "unity of invention" standard. Since at least July 1, 1987, the USPTO has examined international patent applications and PCT national stage applications with this standard. However, this is different than how domestically filed patent applications are examined for the efficiency reasons explained above.

The USPTO has not committed itself to adoption of the "unity of invention" standard, but instead indicated it would consider adoption of the standard. See "USPTO

Study on Restriction Reforms," http://www.uspto.gov/web/patents/greenpaper.pdf (2005); "Study of Alternative Fee Structures," 1239 OG 155 (October 24, 2000), 65 Fed. Reg. 58746 (October 2, 2000); "Request for Comments on Patent Law Treaty," 65 Fed. Reg. 12515 (March 9, 2000), "Unity of Invention and Patent Cooperation Treaty," 52 Fed. Reg. 20038, May 28, 1987 (Final Rulemaking). The USPTO is continuing to review the "unity of invention" standard, and what, if any, changes need to be made to the fee structure to accommodate adoption of that standard. But at this point, there does not appear to be consensus that adoption of this standard for all applications is appropriate. See "USPTO Strategic Plan 2007–2012" at 36 ("The USPTO studied changes needed to adopt a unity standard, including solicitation of public comments. A 'Green Paper' was published for comment in June 2005. Based on the comments, no consensus was reached on the Green Paper options, and the USPTO expects to conclude the study.") http://www.uspto.gov/web/offices/com/strat2007/.

At this time, it is important to maintain flexibility and allow the USPTO to continue to use the "unity of invention" standard only for international applications and applications that enter the national stage from the PCT.

RESPONSES OF LOIS BOLAND TO QUESTIONS SUBMITTED BY SENATOR JOSEPH R. BIDEN, JR.

Question. Did the U.S. Patent and Trademark Office consult with the committee during the course of negotiations on the Singapore Trademark Treaty, the Patent Law Treaty, or the Geneva Act of the Hague Convention?

Answer. The U.S. Patent and Trademark Office (USPTO) had public hearings before the Diplomatic Conferences for the Patent Law Treaty and the Geneva Act of the Hague Agreement, and consulted with many people in the process of preparing for the negotiations for all three treaties. See, e.g., "Request for Comments on Patent Law Treaty," 65 Fed. Reg. 12515–12517, and "Notice of Public Hearing and Request for Comments on the Proposed New Act of the Hague Agreement Concerning the International Registration of Industrial Designs," 64 Fed. Reg. 19135-19139.

Question. In the treaty transmittal packages (109–12; 109–21; and 110–2), the administration recommended a reservation to accompany ratification of the Patent Law Treaty and a number of Declarations to accompany ratification of the Geneva Act of the Hague Agreement. The administration did not suggest the inclusion of any reservations, understandings, or declarations to accompany ratification of the Singapore Treaty. Does the administration stand by these recommendations?

Answer. Yes, the reservation for the FLT is appropriate for the reasons stated in the report of the Department of State accompanying the President's letter of transmittal to the Senate for that treaty. The declarations for the Geneva Act are also appropriate for the reasons stated in the letter of transmittal. However, the text of the declaration under Article 7(2) and Rule 12(3) of the Geneva Act included fee amounts for the individual designation fees for the United States that, while accurate when the original ratification package was drafted, were later amended. We will replace the outdated fee amounts with the current fee amounts in the text of the resolution for advice and consent of the Senate on the ratification of the Geneva Act of the Hague Agreement. Last, no reservation or declaration is recommended for the Singapore Treaty.

Question. Are there any other international agreements that promote the protection of intellectual property to which the United States is currently not a party, that you think we should be party to?

Answer. The USPTO, in conjunction with other USG agencies, regularly reviews treaties concerning the protection and enforcement of intellectual property rights to which the United States is not a party with a view to considering the merits of joining a particular treaty.

To the extent that a treaty to which the United States is not party offers real benefits to American businesses, innovators, and inventors, and does not seem to present any significant downsides for the United States, we would start the process of considering accession to such a treaty in consultation with other relevant agencies, including the State Department and USTR.

We have not identified any multilateral or plurilateral treaties concerning the protection and enforcement of intellectual property rights to which the United States should become a party at this time.

The United States has recently signed bilateral free trade agreements with four countries (the Republic of Korea, Colombia, Peru, and Panama). These agreements

all contain provisions to enhance the protection and enforcement of intellectual property rights. The administration looks forward to working with the Congress to seek approval of these agreements in accordance with the Trade Promotion Act of 2002.

Question. Which countries would you say are most effective—and which ones are the most ineffective—at enforcing piracy of intellectual property? What have you found to be the best mechanisms for enforcing intellectual property protections?

Answer. Most effective—certainly the United States, the EU, and Australia.

Some of the countries that are not addressing IP challenges most effectively are identified in U.S. Trade Representative's (USTR) annual Special 301 report. The 2007 report takes note of enforcement progress in Brazil, for example, and Bulgaria, Croatia, and Latvia were removed from the Special 301 Watch List due to progress in those countries. The 2007 report also notes countries that have the most significant problems with effective IPR protection and enforcement, such as China, Russia, Argentina, India, and Ukraine, where the IP enforcement regimes require important improvements.

USTR and other USG agencies utilize a variety of mechanisms for promoting strong intellectual property regimes around the world. As mentioned above, the Special 301 report is an annual review of the global state of intellectual property rights protection and enforcement. In addition, IP issues are addressed in the context of the World Trade Organization (WTO) and bilateral Free Trade Agreements (FTAs), as both of these provide for regular bilateral engagement and have dispute settlement mechanisms for addressing concerns about implementation of the IP obligations of those agreements. For example, earlier this year, the United States initiated dispute settlement proceedings with China in the WTO on IP enforcement and related market access issues. The WTO accession process provides another avenue for addressing IP concerns. This exercise provides an opportunity for the United States to ensure that acceding countries comply with its obligations under the WTO Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS), including with respect to IP enforcement, upon that country's accession to the WTO. This has been the case with Russia and others, with whom we continue to work aggressively to ensure that they can meet their WTO TRIPS obligations and their bilateral commitments upon accession. We also note that U.S. trade preference programs such as the Generalized System of Preferences, the Andean Trade Preferences Act, the Caribbean Basin Initiative and the African Growth and Opportunity Act, contain eligibility criteria pertaining to the protection and enforcement of intellectual property rights. Finally, IPR protection and enforcement figure regularly and prominently in the context of ongoing diplomatic and trade policy engagements with many U.S. trading partners.

Question. When asked during the hearing about what the most significant barriers are that relate to the protection of intellectual property throughout the world today, you mentioned, among other things, the work that the U.S. Patent and Trademark Office is doing with "the more progressive voices on IP issues and IP enforcement" on "many of the issues we commonly face in Asia." Can you go into greater detail regarding that cooperative work?

Answer. One area of cooperative work is the "STOP" initiative. The "Strategy Targeting Organized Piracy" is an interagency effort with both domestic and international components—including educational outreach; a STOP hotline (1–866–999–HALT), handled by USPTO; USPTO and U.S. Customs and Border Protection cooperation on trademark registrations and notifications; international efforts in Asia and Europe; and partnerships with the private sector.

Internationally, the USPTO has been working diligently with progressive voices on IP issues and IP enforcement, such as Japan, Korea, Singapore, and the European Community to explain the relationship between high levels of intellectual property protection and enforcement and economic and technological development. This is particularly true in the meetings for treaties administered by the World Intellectual Property Organization (WIPO), where the United States regularly consults with these "progressive voices" to promote IP and IP enforcement, and to, where possible, work together to develop shared positions.

In addition to working together with like-minded countries to improve the IP system within WIPO, the United States is working cooperatively, as well as independently, to provide training related to IP. For example, the USPTO will be working together with Singapore to deliver a training program on patents in that country in November, and over this year has worked with the governments of China, Thailand, Vietnam, Hong Kong, and India to train judges, prosecutors, customs officials, police, IP Office staff, and many others. USPTO also coordinates closely with the

Asia-Pacific Economic Cooperation (APEC) and the Association of Southeast Asian Nations (ASEAN) to provide IP-related capacity-building and technical assistance in the region.

Question. Article 30 of the Geneva Act of the Hague Agreement provides that Declarations made at the time of ratification may be withdrawn at any time by a notification addressed to the Director General of the World Intellectual Property Organization. Is it likely or anticipated that any of the declarations that the executive branch has recommended might ultimately be withdrawn by the United States?

Answer. The Declarations explicitly authorized under the Geneva Act of the Hague Agreement are intended to accommodate some countries, such as the United States, that have requirements that are different from those of other countries. For example, in the United States a patent application, such as for a design patent, is required to have a claim in order to receive a filing date, but most other countries do not require such a claim. Therefore, we have recommended that the United States declare that its law requires such a claim. If the U.S. design patent laws were changed in the future to remove that requirement, then the corresponding Declaration could be withdrawn. At this time, we have no information on the likelihood of any such changes.

Question. Article 22(1) of the Singapore Trademark Treaty provides that the Regulations annexed to the treaty cover: (1) Matters which this treaty expressly provides to be "prescribed in the Regulations"; (2) any details useful in the implementation of the provisions of this treaty; (3) any administrative requirements, matters, or procedures; and (4) Model International Forms.

- *a.* Can you explain the meaning of the vague phrase used in Article 22(1)(a)(ii) ("any details useful in the implementation of the provisions of this Treaty")? In particular, the language appears to provide that anything that might be considered to be in furtherance of the implementation of the treaty could be included in the Regulations, which is quite broad. Can you explain whether there are any limitations on this phrase, whether discussed during the negotiations or otherwise?

Answer. The phrase "any details useful in the implementation of the provisions of this Treaty" does provide for any details (i.e., refining points) that may be considered helpful in furtherance of implementation of the treaty. The phrase is limited by the other articles of the treaty insofar as such details must implement treaty provisions. This language is very common in the more recent WIPO treaties—the same phrase appears in intellectual property treaties to which the United States is already a party: Article 17(1)(ii) of the 1994 Trademark Law Treaty (which the Singapore Trademark Treaty is revising), Article 58(1)(iii) of the Patent Cooperation Treaty (PCT) and Article 12(1)(iii) of the Budapest Treaty on the International Recognition of the Deposit of Microorganisms for the Purpose of Patent Procedure. It is also included in Article 24(1)(ii) of the Geneva Act of the Hague Agreement and Article 14(1)(a)(ii) of the Patent Law Treaty (PLT).

The rationale for such language in the Singapore Treaty, along with the other cited treaties, is to ensure flexibility in the operational aspects of the treaties. The PCT and Hague Agreements, for example, provide for international filing systems at WIPO for patents and designs, respectively. The implementation of such systems is extremely technical and could be subject to change based on experiences over time as to what practices are successful or not, as well as based on changes in technology. The regulations governing the details for implementation of these systems may need to respond to such changes in behavior based on lessons learned over time or technological developments.

The PLT and Singapore Treaty involve very technical formalities that focus on what national patent and trademark offices can and cannot require of applicants and registrants. Practices of users and practices of offices change, particularly as technologies change, and the implementing regulations for the treaties need to adapt in order to remain viable, responsive, and relevant. In order to make these treaties viable in the future—without having to renegotiate them every 5–10 years—the regulations must be able to adapt to future realities and situations that we may not even contemplate now.

The very technical nature of these treaties, as well as the provisions of the treaties themselves, provide an inherent limitation on any implementing regulations the Assembly can consider: The regulations cannot exceed and can only implement the treaties' provisions.

- *b.* Do you agree that the list in Article 22(1) regarding the content of the Regulations is exclusive and that, as a result, any proposed amendment to the Regulations that would go beyond the list provided for in Article 22(1) could not be

done through a decision of the Assembly, but would instead require an amendment to the treaty, pursuant to Article 25?

Answer. Yes; the treaty outlines what can be included in the Regulations and thus, the scope of the Regulations cannot exceed the bounds set by Article 22. A proposed amendment to the Regulations that exceeds the scope of Article 22 would not be in the power of the Assembly to effect. In that case, a proposal to amend the treaty pursuant to Article 25 would be required.

Question. Articles 22 and 23 of the Singapore Trademark Treaty make clear that the Assembly can amend the Regulations to the treaty and can do so, under certain circumstances, through a tacit amendment procedure (unless the particular amendment is one that requires unanimity under Article 22(3), amendments to the Regulations can be accomplished by a vote of three-fourths of the votes cast in the Assembly). Without any restrictions on this process, it would seem possible for a member of the Assembly to propose an amendment to the Regulations at a meeting, and if three-fourths of the members vote in favor of it (assuming there is quorum), the amendment could enter into force for all States immediately thereafter. Can you explain the process of amending the Regulations as you envision it under the Singapore Trademark Treaty, with a particular focus on whether there are any restrictions on that process that would prevent the scenario described above? Do you expect the Rules of Procedure that the Assembly is to establish under Article 23(7) to provide restrictions on the amendment process? If so, what sorts of restrictions do you expect to see included in the Rules of Procedure?

Answer. Providing the Assembly to a particular treaty with the ability, under certain circumstances, to amend that treaty's Regulations in this manner is common in WIPO treaties. For example, a similar procedure is included in WIPO treaties to which the United States is a party: The Patent Cooperation Treaty and the Budapest Treaty on the International Recognition of the Deposit of Microorganisms for the Purpose of Patent Procedure. A similar procedure is also found in the Geneva Act of the Hague Agreement and in the Patent Law Treaty (PLT).

At WIPO, the process of making amendments to regulations usually includes discussions in working group meetings well in advance of an Assembly meeting. Moreover, a common practice in WIPO bodies is to take decisions only by consensus. Specifically, Article 23(4)(a) of the Singapore Treaty requires that the Singapore Assembly "shall endeavor to take its decisions by consensus." This language is also included in the PLT and the Geneva Act of the Hague Agreement. The fact is that in all WIPO bodies, if a proposal does not find consensus support, the proposal is nearly always withdrawn, rather than moved to a vote. For that reason, an amendment of the Singapore Treaty Regulations by way of a three-fourths vote would likely only occur in extraordinary circumstances.

Also, since the Regulations cover only technical implementation or administrative provisions, any amendment to the Regulations would likely be simple to implement through change in practice at the USPTO or, in some cases, rulemaking. Generally, there are no provisions in the Singapore Treaty Regulations at present that would, if changed, require an amendment to a U.S. statute.

RESPONSES OF JOHN HARRINGTON TO QUESTIONS FROM SENATOR JOSEPH R. BIDEN, JR.

Question 1. Please provide an overview of the current process by which the U.S. Department of Treasury consults with private-sector organizations, including professional organizations, on tax treaties. Please provide an overview of the process by which the Department incorporates any input provided by such organizations into U.S. tax policy. Can you describe specific examples of where input from the public has been incorporated into your negotiating strategy and ultimately the text of tax treaties negotiated? Do you have, or have you considered establishing, a federal advisory committee, consistent with the requirements of the Federal Advisory Committee Act, on international tax policy? Have you asked for public comments on the 2006 U.S. Model Tax Treaty and its accompanying technical explanation? If not, why not?

Answer. The Treasury Department uses many sources of information to form its tax treaty policy and priorities. Because the major goal of tax treaties is to reduce double or excessive taxation, the Treasury Department relies on taxpayer input in identifying countries with which tax treaties are needed and with which existing tax treaties need to be improved.

Comments and suggestions that we have received from taxpayers and taxpayer groups have been instrumental in setting tax treaty policy and priorities. In certain

cases, in response to comments we have modified or refined our negotiating positions as reflected in specific model treaty provisions. For example, the current model treaty language in Article 10(4), regarding dividends from Real Estate Investment Trusts (REITs), resulted from discussions with the REIT industry, including the National Association of Real Estate Investment Trusts. In other cases, in light of taxpayer input, we have adopted a particular provision in treaties in which it was appropriate to include the provision. For example, the "Zero Dividend Withholding Coalition," a broad-based group of U.S.- and non-U.S.-based multinational companies, called for a change in tax treaty policy with respect to dividends in its 1999 paper, "Zero Withholding on Direct Dividends: Policy Arguments for a New U.S. Treaty Model." More recently, the National Foreign Trade Counsel in its paper "NFTC Tax Treaty Project: Towards a U.S. Tax Treaty Policy for the Future: Issues and Recommendations" (May 26, 2005), called for the adoption of arbitration provisions. Mandatory arbitration provisions were included in two of the agreements before the committee.

We publicized the release of the 2006 Model Income Tax Convention and Model Technical Explanation, issuing a press release and posting the documents on the Treasury Department Web site. We have received formal and informal comments in response to the release of the model treaty and technical explanation. Staff of the Office of the International Tax Counsel regularly participate in conferences in which staff discuss tax treaty issues, including the model tax treaty, and solicit feedback on the model tax treaty and tax treaty policy in general.

The Treasury Department has been very appreciative of the formal and informal comments that it receives from taxpayers and from trade associations, such as the NFTC, regarding tax treaty provisions and tax treaty priorities. In addition, professional associations, such as the New York State Bar Association Tax Section, have raised questions and provided analysis that we have considered, and continue to consider. All of this input has been very helpful in the tax treaty area, and we are satisfied with the quality and level of input received.

From a broader international tax policy standpoint, the Treasury Department has been carefully considering views from a variety of sources. For example, the Secretary recently hosted a conference on Business Taxation and Global Competitiveness, which invited a wide range of experts and affected taxpayers to discuss the effect of current tax policy on competitiveness. Accordingly, we have not found it necessary to establish a Federal advisory committee regarding international tax policy to elicit public comments.

Question 2. How many people were employed by the Office of the International Tax Counsel to work on tax treaties and related issues 10 years ago? How many people are employed by the Office to work on tax treaties and related issues now? Has the workload over the last 10 years increased?

Answer. In 1997, 10 attorneys were part of the Office of the International Tax Counsel. None worked on tax treaties exclusively, but nearly all attorneys devoted part of their time to working on tax treaties and related issues. Currently, there are seven attorneys in the Office of the International Tax Counsel, all of whom work to some extent on tax treaty and related issues.

Although the number of attorneys in the Office of the International Tax Counsel is currently slightly lower than it was 10 years ago, the commitment to tax treaty negotiation and guidance remains strong. Since 1997, a Deputy International Tax Counsel position has been created that focuses nearly exclusively on tax treaty issues. In addition, there is a Deputy Assistant Secretary (International Tax Affairs) position with responsibility for treaty matters.

Because the tax treaty workload is affected by multiple factors, it is difficult to generalize about changes in resources and outputs. In particular, snapshot comparisons can be misleading. For example, some tax treaty negotiations are more time-consuming than others. Important tax treaty related work at the Organization for Economic Cooperation and Development (OECD) ebbs and flows as well, affecting resources that can be used for bilateral negotiations. In short, the Office of the International Tax Counsel devoted significant resources to its tax treaty program 10 years ago and continues to devote significant resources today.

Question 3. As you know, the N.Y. State Bar Association's Tax Section recommended in its report on the 2006 U.S. Model Tax Treaty that the Treasury Department expand the Technical Explanation of the model to include an explanation of the changes to U.S. Tax Treaty policy reflected in the model, the reasons for those changes, and the relationship between the provisions of the model and current U.S. tax law. In addition, practitioners have noted that it might be beneficial for the Department to publish more guidance on tax issues associated with the application of the various tax treaties that are currently in force. What is your view

regarding these recommendations? Are these recommendations not being acted upon because of a shortage of resources?

Answer. The New York State Bar Association's Tax Section, in its April 2007 report, raises the question whether the Treasury Department should produce and publish an explanation of the changes to U.S. tax treaty policy reflected in updates to the model income tax convention, the reasons for those changes, and the relationship between the provisions of the model income tax convention and current U.S. tax law. The Office of the International Tax Counsel is considering this and other recommendations made by the New York State Bar Association's Tax Section in its report.

The press release accompanying the release of the 2006 U.S. Model Income Tax Convention and Model Technical Explanation notes that the U.S. Model Income Tax Convention is used as a starting point in bilateral treaty negotiations with other countries. The Treasury Department makes this starting point public by periodically updating and releasing its model income tax convention. The issuance of a new model income tax convention becomes necessary when the cumulative effect of changes in tax law and tax treaty policy has made our "old" model tax treaty no longer an appropriate starting point.

The 2006 Model Income Tax Convention is consistent with our most recent tax treaties and reflects changes in U.S. domestic law and tax treaty policy since the U.S. model was last updated in September 1996. It is not clear how an explanation of the changes to U.S. tax treaty policy, the reasons for those changes, and the relationship between the different articles of the model and U.S. tax law is helpful in light of the role of the model income tax convention and technical explanation as a starting point in bilateral tax treaty negotiations. Nonetheless, we are cognizant of the interest in such additional information, and we continue to weigh whether and how historical and explanatory information could be provided without inadvertently creating uncertainty or confusion with respect to previously negotiated agreements.

We also recognize the importance of providing published guidance with respect to income tax treaties. The following treaty-related guidance has been published in the Internal Revenue Bulletin in the last 3 years:

- Announcement 2007–05, 2007–36 I.R.B. 540 (Mutual agreement concerning the eligibility of certain pension and other employee benefit arrangements for benefits under U.S.-Netherlands treaty);
- Announcement 2006–86, 2006–45 I.R.B. 842 (Mutual agreement concerning the elimination of double taxation as a result of the interaction of the U.K. nonresident company group relief rules and the U.S. dual consolidated loss rules);
- Notice 2006–101, 2006–47 I.R.B. 930 (Guidance on U.S. income tax treaties that meet the requirements of section 1(h)(11)(C)(i)(II));
- Announcement 2006–21, 2006–1 C.B. 703 (Mutual agreement concerning the treatment under the U.S.-Spain treaty of limited liability companies, S corporations, and other business entities treated as partnerships or disregarded entities for U.S. tax purposes);
- Announcement 2006–19, 2006–1 C.B. 674 (Mutual agreement concerning the treatment under the U.S.-Ireland treaty of Irish common contractual funds);
- Announcement 2006–20, 2006–1 C.B. 675 (Notification of self certification of United States and Japanese resident investment banks, pursuant to section E of the U.S.-Japan investment bank Memorandum of Understanding or MOU);
- Announcement 2006–6, 2006–1 C.B. 340 (MOU regarding the term "investment bank" in the U.S.-Japan treaty);
- Announcement 2006–7, 2006–1 C.B. 342 (MOU providing guidelines and procedures to resolve factual disagreements under the mutual agreement article of the U.S.-Canada treaty);
- Announcement 2006–8, 2006–1 C.B. 344 (Mutual agreement concerning the treatment of fiscally transparent entities under the U.S.-Mexico income tax treaty);
- Announcement 2005–72, 2005–41 I.R.B. 692 (Mutual agreement concerning the treatment of fiscally transparent entities under the U.S.-Mexico income tax treaty);
- Announcement 2005–30, 2005–1 C.B. 988 (Mutual agreement concerning the eligibility of certain U.K. pension arrangements for benefits under Article 10 of the U.S.-U.K. treaty);
- Announcement 2005–22, 2005–1 C.B. 826 (Mutual agreement concerning the treatment of scholarships under the U.S.-Austria treaty);

- Announcement 2005–17, 2005–1 C.B. 673 (Mutual agreement concerning the treatment under the U.S.-New Zealand treaty of income derived through certain fiscally transparent entities);
- Announcement 2005–3, 2005–1 C.B. 270 (Mutual agreement concerning the eligibility of pension arrangements for benefits under the U.S.-Switzerland treaty);
- Announcement 2004–60, 2004–2 C.B. 43 (Guidance on effective dates under the U.S.-Japan treaty); and
- Rev. Rul. 2004–76, 2004–2 C.B. 111 (Guidance clarifying the ability of dual resident corporations to choose between two U.S. treaties).

We are currently working on additional guidance in the tax treaty area regarding beneficial ownership and other issues.

Question 4. The 1996 U.S. Model Tax Treaty includes provisions in Article 2, which require the competent authorities of the Contracting States to notify each other of relevant changes in their domestic tax law and any official published materials concerning the application of the relevant tax treaty. The 2006 U.S. Model Tax Treaty no longer contains these provisions. This change in the Model Tax Treaty is reflected in the Belgian Tax Treaty currently under consideration. The existing income tax treaty with Belgium, which was concluded in 1970, contains the 1996 model information-sharing provisions in Article 2. The new treaty does not include such information-sharing provisions. Can you explain why this is a beneficial development? Wouldn't a blanket information-sharing provision of the type included in the prior tax treaty model be particularly useful in treaties that contain binding arbitration provisions such as those included in the Belgian Tax Treaty and the German Protocol, given that the arbitration boards in these two treaties are instructed to apply after the text of the treaty and "any agreed commentaries or explanations of the Contracting States" when interpreting the treaty, "the laws of the Contracting States to the extent they are not inconsistent with each other"?

Answer. Article 2, paragraph 4 of the 2006 U.S. Model Income Tax Convention requires the competent authorities to notify each other of any change in law that significantly affects obligations under the convention. Unlike the 1996 U.S. model provision, the provision in the 2006 U.S. model no longer requires notification of any other published material regarding the convention. This change to Article 2 of the U.S. model is similar to the corresponding provisions in other model tax treaties, such as the OECD and U.N. models, and in recent U.S. tax treaties, such as the new conventions with the U.K. and Japan. The ease with which published materials can be obtained (e.g., through the Internet) has made this formal and—if required for any published material—burdensome exchange requirement superfluous. Thus, all important information must continue to be exchanged, but the competent authorities are no longer required to provide to each other readily available material that has no significant impact on the treaty or the taxes covered by the treaty.

We do not believe that an arbitration provision recreates the need for a broader provision requiring exchange of published materials. Appropriate exchange is important in the mutual agreement procedure generally, whether the competent authorities are negotiating or whether the case is in arbitration. Further, the countries have a responsibility to deal with each other in good faith and, therefore, to disclose all relevant published interpretations during a mutual agreement procedure (MAP) proceeding. Nor have we found the narrower 2006 U.S. Model Income Tax Convention language to be an issue in practice, particularly since the taxpayer and each country have an interest in researching and raising any relevant tax laws and published interpretations during a MAP proceeding and since advances in technology and other developments have made international tax research easier.

Question 5. Have we in the past ever shared our technical explanations with our treaty partners? If so, was this done as a matter of course with every country we concluded a tax treaty with, or only with some countries? If only with some countries, what criteria were employed when making the decision to share a particular technical explanation? What is our current practice? Please explain the reasoning behind our current practice. Do you expect to maintain the current practice with no changes?

Answer. There have been periods in the past when the Treasury Department regularly shared technical explanations with treaty partners at some point before the technical explanations were released to the public. This was generally done, however, as a courtesy, and the treaty partner was under no obligation to agree with, or even to read, the technical explanations. Our recent practice has been to refer the prospective treaty partner to the model treaty and technical explanation posted on the Treasury Department Web site and to refer to the technical explanation of the model treaty during negotiations when appropriate to achieve a common under-

standing. Although we would be willing to share drafts of the treaty-specific technical explanation with any treaty partner before public release, treaty partners typically do not ask to see it. There are of course exceptions. For example, in 2002, the U.K. commented on the technical explanation to the new U.S.-U.K. treaty prior to its release, in part because the treaty contained some provisions that had not yet been interpreted by either party (and thus were not reflected in a published technical explanation). In addition, Canada routinely requests to adopt an agreed technical explanation.

Because this case-by-case approach to sharing technical explanations has worked well in practice, we expect to maintain it for the foreseeable future.

Question 6. The German Protocol differs from the recently updated U.S. Model Tax Treaty with respect to the taxation of Social Security benefits. The Model Tax Treaty provides that Social Security benefits are taxable in the "source" country (i.e., the country that pays the benefit); however, Article VIII of the German Protocol provides that Social Security benefits paid in one treaty country to a resident of the other treaty country shall be taxable in the other country, and taxed as if they were provided by the country of residence. The Joint Declaration signed on June 1, 2006, reflects an understanding that this, among other things, will be the subject of consultations on or after January 2013.

- *a.* Recognizing that the German Protocol maintains the status quo with respect to the current German Tax Treaty, can you explain the reason for deviating from the Model Tax Treaty with Germany?
- *b.* In the Joint Declaration it is made clear that the renegotiation of this provision is intended to make it possible for "[b]enefits paid under the Social Security legislation of a Contracting State [to be] taxed by that Contracting State. . . ." Is it correct to assume that, in future negotiations, Treasury will additionally seek to cut back on the ability of the country of residence to tax such Social Security benefits in order to avoid double taxation of Social Security benefits?

Answer. Like other departures from the U.S. model, the provision on taxation of Social Security benefits in the U.S.-Germany tax treaty was the result of the negotiation process. We plainly would have preferred exclusive source country taxation of Social Security benefits, in accord with the U.S. model, but this provision was one of many items being negotiated in the agreement, and its resolution is reflected in the overall balance of the agreement.

The Joint Declaration with Germany takes a significant step in moving the U.S.-Germany Tax Treaty closer to the U.S. model position on the taxation of Social Security benefits. It provides that the countries will enter into consultations to amend the proposed agreement to allow for source country taxation of Social Security benefits. If both the source and residence country are able to tax Social Security benefits, the residence country would provide a foreign tax credit to avoid double taxation of such income.

Question 7. In Article 3 of the 1996 U.S. Model Tax Treaty, the term "qualified governmental entity" was explicitly defined and the definition made clear that such entities included noncommercial entities and governmental pension funds. The 2006 U.S. Model Tax Treaty no longer uses the term "qualified governmental entity" and deals separately with pension funds, but as a result, it appears that under the new Model Tax Treaty, for example, a Federal or U.S. State noncommercial entity that is not a pension fund that receives dividends in a treaty-partner country by virtue of an investment made in that country, could have those dividends taxed by the other treaty country. Is this correct? If so, is this an issue you intend to address in future treaties?

Answer. The 1996 U.S. Model Income Tax Convention included a definition of "qualified governmental entities" (QGEs). The definition encompassed certain noncommercial entities wholly owned by a Contracting State or a political subdivision or local authority, as well governmental pension funds. The definition of QGE was primarily relevant for purposes of Article 4 (Residence) (clarifying that QGEs are residents), Article 10 (Dividends) (providing a reciprocal exemption from dividend withholding taxes for QGEs), and Article 22 (Limitation on Benefits) (providing that QGEs are entitled to all treaty benefits).

The term QGE was not included in previous U.S. models or in the OECD model. Although the term was introduced to facilitate certain clarifications (e.g., to Article 4 that the government of each State, as well as any political subdivision or local authority thereof, is a resident of that State), the Treasury Department found in practice that it was more straightforward to incorporate the desired clarifications directly into the articles on residence and limitation on benefits. Accordingly, the 2006 U.S. Model Income Tax Convention eliminates the use of the term QGE, with

Article 4 and Article 22 referring directly to the Contracting States and their political subdivisions and local authorities.

With respect to dividends, the problem of potential unrelieved double taxation is most relevant with respect to pension funds. Pension funds normally cannot benefit from a foreign tax credit (because they do not normally pay tax) and their beneficiaries generally cannot claim a foreign tax credit when they receive the pension (because the character of the underlying income does not pass through upon distribution and the distribution is generally made many years after the foreign tax would have been imposed). Accordingly, in the absence of an exemption for pension funds, dividends would almost certainly be subject to unrelieved double taxation. The 2006 U.S. Model Treaty, therefore, provides in paragraph 3 of Article 10 (Dividends) that dividends received by a pension fund generally may not be taxed in the Contracting State of which the company paying the dividend is a resident.

It is possible that a Federal or U.S. State noncommercial entity that (a) is not a pension fund and (b) receives dividends in a treaty-partner country by virtue of an investment made in that country could have those dividends taxed by the other treaty country. The definition of a QGE was excluded from the 2006 U.S. Model Tax Treaty, however, only after an assessment of where the potential for unrelieved double taxation was most acute (with respect to pension funds) and a recognition of our limited success in negotiating broader coverage. Nevertheless, we will of course consider all input we receive with respect to changes in the 2006 U.S. Model Income Tax Convention and take that input into account in future negotiations.

Question 8. Both the German Protocol and the Belgian Tax Treaty include provisions related to cross-border pension contributions and earnings, which generally track Article 18 (2) and (3) of the 2006 U.S. Model Tax Treaty and prevent the taxation of pension contributions and earnings when an individual participates in a pension plan established in one country while performing services in the other, provided certain requirements are met. One such requirement is that the competent authority in the country where the services are performed must agree that the pension plan "generally corresponds" to a pension plan in that country. For purposes of this requirement, the German Protocol helpfully identifies in Article XVI(16) specific types of plans in the United States and in Germany that qualify, making it unnecessary to obtain a specific ruling from the competent authorities with respect to the pension plans that have been identified. This "preapproval" of certain plans would streamline what can be a cumbersome process and thus is a welcome development to taxpayers. The Belgian Treaty does not follow the example of the German Protocol of identifying prequalified plans in the treaty; however, the Department makes clear in the Technical Explanation (on p. 60) that there will be further discussions on this matter with Belgium, at which time the countries will hopefully "agree upon a list of pension plans that are acceptable." Have the negotiations on this agreed list of eligible pension plans begun? Do you have a sense of when an agreement will be concluded? Do you anticipate that this agreement will be an international agreement, reportable under the Case Act (1 U.S.C. § 112b)?

Answer. During the negotiations of the U.S.-Belgium Tax Treaty, the countries were not able to enter into an advance agreement as to which types of pension plans will be considered to "generally correspond" to plans in the other country for purposes of the pension contribution provisions in Article 17. However, U.S. and Belgian tax authorities have exchanged lists of the types of plans that they believe should be covered. Each country has provided the lists to the official who will be its competent authority under the tax treaty, with the expectation that a generally applicable competent authority agreement will be entered into under Article 24 of the new treaty shortly after the treaty enters into force. The usual procedure is to post the text of the competent authority agreement on the IRS' Web site and to publish it in the Internal Revenue Bulletin.

We would not expect to report the agreed list of acceptable pension plans under the Case Act, as we would consider it an "implementing agreement" specifically contemplated by the treaty.

Question 9. There are features of the arbitration provision that are included in both the German and Belgian Tax Protocols, which might be improved upon in future instruments, or varied, depending on who our treaty partner is and of course, what their concerns and requirements are in the context of each negotiation. While recognizing that the Department has only partial control over the final text of negotiated arbitration provisions, the following questions are intended to further our dialog on the subject of arbitration and explore options that may be appropriate for future treaties:

- *9a.* The Belgian and German arbitration models provide that "[t]he determination reached by an arbitration board in the proceeding shall be limited to a determination regarding the amount of income, expense, or tax reportable to the Contracting States" and that the board "shall not state a rationale." What do you consider to be the benefits and drawbacks of allowing an arbitration board to produce a reasoned opinion when deciding a case under a tax treaty? Have you considered the option of allowing arbitration boards to provide reasoned advisory opinions that are strictly advisory, which would not be legally binding on future arbitration boards, but could nevertheless be considered helpful to competent authorities and taxpayers who want to understand the thinking of the arbitrators in coming to a decision?

Answer. The arbitration process in the proposed U.S.-Belgium treaty and U.S.-Germany protocol is an extension of the competent authority process, and is meant to increase the efficiency and effectiveness of that process. The arbitration process in those two agreements is a simplified arbitration process invoked to overcome a stalemate between the competent authorities in the negotiation of an agreement under the normal mutual agreement procedure (MAP) available under the treaty. The result of this simplified arbitration process is still a MAP agreement, which has all the same features, and retains all the same rights for the taxpayer, as a MAP agreement reached solely by competent authority negotiation. MAP agreements are confidential and in general do not provide a rationale for the agreement reached. A MAP agreement reached through arbitration will be confidential to the same extent as a MAP agreement reached purely through negotiation, and the redactions necessary to maintain this confidentiality may limit the utility to the public of a reasoned opinion of the arbiters.

In general, the main benefit of a reasoned opinion of the arbiters is that it would provide greater transparency regarding the decision made by the arbiters. This greater transparency would come at a significant cost, however. Requiring a written explanation would delay the resolution of the dispute because the arbiters would have to agree not only on which country's position was the better of the two but also the reasons for the decision. In addition, documents submitted in the process would be more lengthy and more time-consuming to produce because the parties would need to argue for a particular rationale (as the rationale given could affect other cases or the particular taxpayer's future behavior) in addition to arguing that they reached the more reasonable result in eliminating double taxation given the facts and the law.

Further, the written explanations would create, at least informally, an additional body of law to that created by the governments and domestic courts. This could create confusion in cases where the reasoned opinion conflicted with judicial opinions or published guidance by the governments. For those reasons, prospective treaty partners may view the production of a reasoned arbiters' opinion as a reason not to agree to have arbitration be part of the MAP procedure.

The primary goal of the arbitration process in the U.S.-Belgium treaty and U.S.-Germany Protocol is speedy resolution of a dispute between the competent authorities regarding the granting of relief to a taxpayer suffering double taxation. Speedy and efficient resolution of the dispute is essential because the only cases going to arbitration are those in which the competent authorities could not agree within 2 years. Accordingly, many of the features present in a judicial-style arbitration process, such as the production of a reasoned opinion, are contrary to the purpose of the adoption of arbitration in this case.

Nonetheless, we recognize that obtaining at least informal feedback from the arbiters could be helpful to the competent authorities and taxpayers, and we will continue to consider whether informal opportunities for feedback should be pursued. We also recognize that the proposed arbitration process is not the only way to resolve disputes between the competent authorities, and we will continue to consider alternatives to the process as we monitor its use and the receptivity of treaty partners to this and other approaches.

- *9b.* The Belgian and German arbitration models provide that the arbitration board's decision shall "have no precedential value." Have you considered whether it would be useful in the context of some treaty relationships, particularly more contentious ones, to provide the arbitration board's decisions with precedential value?

Answer. With respect to Belgium and Germany, we expect the existence of the arbitration process to narrow the areas for disagreement between the competent authorities and to facilitate agreement within 2 years. Thus, we expect to have few cases go to arbitration.

With respect to future treaty partners, if we believe that the arbitration process may become a common dispute resolution mechanism with a specific treaty partner, we would consider whether precedential decisions would be appropriate in that treaty context. It is clearly possible that, in certain treaty relationships, there could be value to precedential arbitration decisions that play a role in reducing future disputes in particular subject areas sufficient to overcome the disadvantages inherent in giving precedential value to the board's decision (which we assume would need to be accompanied by a reasoned opinion).

In considering whether to allow precedential decisions, we would have to give great weight to the concerns of ceding to an arbitration panel the authority to bind the United States not only to a particular result but also to a particular interpretation and application of a specific treaty, especially if taxpayers begin to apply released decisions to analogous situations and analogous provisions in other treaties (and especially as third-country treaty partners would not themselves be bound by these opinions). In addition, our primary goal in proposing the arbitration process is the prompt, efficient relief of contentious double taxation cases. The production of reasoned decisions, whether precedential or not, is likely to take longer than the approach taken in the agreements with Belgium and Germany that provides a result-only decision with no precedential value. In any case, based on preliminary discussions with other treaty partners, it appears that the result-only approach taken in the agreements with Belgium and Germany is more likely to find acceptance with treaty partners with whom the United States has more difficult discussions than an approach that would result in precedential opinions. However, we will continue to consider modifications as we monitor the use of the arbitration provision, particularly with respect to countries with which we have difficulties in resolving disputes.

- *9c.* In your testimony, you remarked that Treasury views the arbitration mechanism as providing competent authorities with an incentive to resolve existing disputes, rather than have those disputes be subject to the determination of an arbitration board. The existing examples of binding arbitration provisions appear at least informally to support your thesis outside the scope of transfer pricing double tax cases, yet existing examples of binding arbitration provide for reasoned decisions that are binding on future arbitral boards. Do you think that a model that provides that the arbitral tribunal's decisions shall have "no precedential value" will create the same incentive to settle a case prior to arbitration as existing examples in which the decisions have precedential value? If so, why?

Answer. We adopted mandatory arbitration incorporating the last-best offer approach in the proposed agreements with Belgium and Germany because the Treasury Department believes that mechanism is most likely to encourage the competent authorities to resolve the case before it reaches arbitration. Because under last-best offer arbitration one of the two proposed resolutions will be chosen, the Treasury Department believes it encourages the competent authorities to be more reasonable in their negotiations and resolve a case on their own. In the context of the last-best offer approach, we do not believe that precedential opinions would increase the incentive to reach agreement. Further, because the arbiters must choose between one of the two offers made by the competent authorities, decisions of previous panels are likely to be of limited value in resolving a specific dispute, even if they relate to the same subject matter.

Nonetheless, we will continue to search for ways to increase the effectiveness of the process, which is in the best interest of all the affected parties.

- *9d.* Can you explain precisely how you expect to monitor the success of the arbitration provisions that are contained in the German and Belgian tax treaties?

Answer. The goal of the arbitration provision is to increase the efficient and effective resolution of double taxation cases in the mutual agreement procedure (MAP) before they reach arbitration and to assure their efficient and effective resolution if they reach arbitration. As with other treaty provisions, as we gain more experience with the arbitration provision, we may find that certain refinements of the process are needed. In particular, we have been carefully considering means of monitoring the implementation of the arbitration provision. Accordingly, we expect to use the following data to assess the arbitration process adopted in the agreements with Germany and Belgium.

1. Extent to which double taxation relieved/amount of time needed to relieve double taxation

A primary purpose of our income tax conventions is to prevent double taxation. Accordingly, the competent authorities use the MAP to settle disputes regarding, for example, how to allocate income so that the profits of a taxpayer (or affiliated group)

are not taxed twice. In measuring the effectiveness of the MAP, we currently look at (1) the degree to which the taxpayer was relieved from double taxation, and (2) the amount of time it takes to conclude the procedure.

We believe that these measures should also apply to evaluate the performance of the arbitration phase of the MAP. Therefore, we intend to measure the effect of the arbitration provision on reaching timely and effective resolutions in the MAP process, both with respect to cases that go to arbitration and in negotiations in general.

2. Number of cases that go to arbitration/types of cases that go to arbitration

We plan to track the number of times the arbitration provision is invoked and the types of cases. Because the arbitration provision is to encourage mutual agreement by the competent authorities, we would generally view extensive use of this provision unfavorably. One possible exception to this general view might be where there is significant use but it involves only one particular treaty country, or a particular type of case with a country, so long as there is a downward trend in the use of the provision.

3. Number of cases entering competent authority

Another measure of success of the arbitration provision would be the effect of the provision on the number of cases entering competent authority. With some treaty partners, an increase in the number of cases that go to the competent authorities may signal an increase in taxpayer confidence that double taxation issues will be effectively and efficiently resolved.

- *9e.* How many disputes have been subject to the existing Mutual Agreement Procedures of the treaties with Germany and Belgium over the last 10 years? Please break this information down by year and by subject matter.

Answer.

Fiscal year	No. cases received	Allocation of income	Other
Belgium:			
1997	1	1	—
1998	1	1	—
1999	2	2	—
2000	4	4	—
2001	0	—	—
2002	2	1	1
2003	1	1	—
2004	0	—	—
2005	3	3	—
2006	2	1	1
2007	1	1	—
Germany:			
1997	5	3	2
1998	4	3	1
1999	5	5	—
2000	17	9	8
2001	8	5	3
2002	9	6	3
2003	14	3	11
2004	14	7	7
2005	19	10	9
2006	16	4	12
2007	19	8	11

Because of the Record Retention Act's restriction on the maintenance of records for more than 6 years, information from the 1990s is incomplete. It seems likely that there were a few more cases with Germany than are reflected in the information that is currently available.

The "Allocation of Income" cases consist almost entirely of transfer-pricing issues. A survey of the existing cases indicates that most issues in the "Other" category concern whether business activities are associated with permanent establishments and/or the amount of business profits attributable to permanent establishments. However, the "Other" category also includes issues such as the sourcing of stock options, qualification of organizations as exempt, the residency of taxpayers, and issues arising under the estate and gift tax treaty.

- *9f.* You noted in your testimony that taxpayer input into the arbitration process would be difficult in light of the "last best offer" structure of the mechanism, which provides that the arbiters select from the two options proposed by the competent authorities involved. I do not, however, find this to be convincing. For example, taxpayer information might be usefully supplied in support of one of the options proposed by a competent authority. Can you identify any other drawbacks to providing for taxpayer participation in the arbitration process?

Answer. The arbitration provision in the agreements with Belgium and Germany is designed to be an extension of the competent authority negotiation process that will provide for more effective and efficient resolution of cases in which a taxpayer is experiencing double taxation. In general, although a competent authority negotiation is a government-to-government process, taxpayers may be, and often are, very involved.

During the development of the issues in the case and during the actual competent authority negotiation process, the taxpayer can provide significant and very helpful input to the competent authorities, and the United States seeks and encourages such taxpayer input. The taxpayer is especially helpful in presenting the facts, but the taxpayer also may present legal arguments to the competent authority to assist in the resolution of its case.

If the case goes to arbitration under the proposed agreement, the taxpayer's position on the matter will be taken into account by the U.S. competent authority, who may enlist additional assistance from the taxpayer throughout the process.

We believe that the proposed arbitration process, which allows for taxpayer input to the same extent permitted in the general mutual agreement procedure, strikes the appropriate balance between allowing taxpayer input, while maintaining the efficiency and effectiveness of the process. Nevertheless, we will continue to search for ways to increase the effectiveness of the process, in the best interest of all the affected parties, including potential opportunities for additional taxpayer input.

- *9g.* The Belgian and German arbitration models allow the taxpayer to opt out of the arbitral process at any time, including after a decision has been rendered by the arbitration board. What do you consider to be the benefits and drawbacks of the ability of taxpayers to opt out throughout the process?

Answer. In general, mutual agreement proceedings are initiated at the request of the taxpayer, and the taxpayer retains the right to rescind its request during negotiation. Moreover, the taxpayer can reject a negotiated and concluded mutual agreement procedure (MAP) agreement and pursue its remedies in court.

The arbitration process included in the agreements with Belgium and Germany is an extension of the standard MAP and is meant to increase the efficiency and effectiveness of that process by providing a mechanism for resolution of cases that could not be concluded by negotiation. As such, the arbitration process is not meant to limit in any way the rights of the taxpayer to reject a MAP agreement and pursue remedies in court. That is, the arbitration process is intended to produce an effective and efficient resolution of a taxpayer's case through a MAP agreement, with the taxpayer retaining all rights, whether the agreement is produced through traditional negotiation or through arbitration.

- *9h.* The Belgian and German arbitration models provide that in establishing an arbitration board, each Contracting State appoints a member and then those two members appoint a third member, who will serve as the chair of the board. This structure appears to permit Contracting States to appoint as arbiters government employees, who would likely be perceived as lacking independence and objectivity. Have you considered alternative mechanisms for the appointment of arbiters, which would further promote the appearance of an independent and impartial proceeding? Please describe the various alternatives you've considered and include the perceived benefits and drawbacks of each mechanism.

Answer. During the development of the proposed arbitration mechanism, we carefully considered the appropriate criteria and qualifications for potential arbiters. We considered the possibility of appointing professional arbiters such as those affiliated with the American Arbitration Association or the International Centre for Settlement of Investment Disputes, who would likely be perceived as independent. However, such persons would be very unlikely to have the extensive technical knowledge of international tax law, particularly tax treaties, necessary to make an informed decision in the issues most likely to arise in a mutual agreement procedure case. We concluded it was better to provide for an arbitration panel consisting of taxation experts, particularly in light of the objective of issuing an expeditious decision.

We also considered the possibility of identifying a list of potential arbiters, from among whom the board would be jointly selected by the competent authorities. This

alternative is available under the European Union Arbitration Convention, and at least on the surface seems to hold out a possibility of both independence and ease of selection. However, we have heard reports of difficulties in keeping the list up-to-date, assuring the appropriate level of technical knowledge of the arbiters on the list, and agreeing on multiple arbiters from the list to decide a particular case. We have provided, nevertheless, in the agreements with Belgium and Germany for a nonexclusive list developed by the competent authorities of individuals with familiarity in international tax matters who may potentially serve as the third member and chair of the board. In general, the mechanism agreed upon with Belgium and Germany allows each government to appoint a member of the panel, after which those members choose a third-country chair. The mechanism provides for an alternative chair appointment procedure in the event of a disagreement between the two board members on choice of a chair.

A government may in fact choose to appoint to the board a person in the government's employ, and might do so if concerned about expertise in the specific issue or about potential costs of arbitration. We recognize that an arbiter who is a government employee may not be perceived as independent. We also recognize that selection of a government employee carries risks for the government because such person might have less credibility with the third-country chair of the panel and, thus, may actually reduce the likelihood that the board will adopt that government's position.

We will monitor the operation of the arbitration process, including the selection of the board, and expect to have further discussions with our treaty partners concerning the issue, with a view toward achieving the best balance of the concerns expressed and providing to taxpayers an efficient and effective resolution of their double taxation cases.

- *9i.* The Belgian and German arbitration models lay out the sources to be used by each arbitration board when interpreting relevant treaty provisions in a particular dispute. Specifically, both instruments provide that the arbitration board shall apply in descending order of priority (a) the provisions of the treaty; (b) any agreed commentaries or explanations of the Contracting States concerning the convention; (c) the laws of the Contracting States to the extent they are not inconsistent with each other; and (d) any OECD Commentary, Guidelines or Reports regarding relevant analogous portions of the OECD Model Tax Convention. This list is perhaps similar, but is not fully consistent with, the customary international law rules of treaty interpretation as laid out in the Vienna Convention on the Law of Treaties, which the United States has consistently stated it applies when interpreting treaties to which it is a party.[1] In the future, might you consider referring to the Vienna Convention rules for treaty interpretation, rather than the list provided for in the German and Belgian treaties?

Answer. The list of authorities in the proposed agreements reflects the documents that the U.S. competent authority has found most useful in its own tax treaty interpretation. However, we will continue to monitor the process and search for ways to increase its effectiveness, keeping in mind customary international law rules of treaty interpretation as reflected in the Vienna Convention, including an assessment of the utility of the list of authorities.

- *9j.* The Belgian and German arbitration models provide that the arbitration board may adopt any procedures necessary for the conduct of its business, provided that the procedures are not inconsistent with the treaty. The procedural rules adopted and used by an arbitration tribunal are crucial to the operation of every proceeding and can have an enormous impact on whether the arbitral process is fair and a reasonable outcome reached. As a result, many international agreements that provide for binding arbitration, choose the rules of procedure applicable to any arbitration proceedings beforehand, as in the case of many of our trade agreements. Have you considered doing so in future tax treaties?

Answer. During negotiation of the proposed agreements with Belgium and Germany, consideration was given to identifying additional rules of procedure for use by the arbitration board. However, after studying the details of the rules commonly used in commercial arbitration, we concluded that most of these rules relate to evidentiary procedures not relevant to the simplified arbitration format proposed in the

[1] See S. Exec. Doc L, 92nd Cong. (1971) (stating that the Vienna Convention on the Law of Treaties is generally recognized as the authoritative guide to current treaty law and practice). See also Brief for the United States as Amicus Curiae at 8, *Domingues* v. *Nev.*, 528 U.S. 963 (1999) (noting that "[m]ost provisions of the Vienna Convention, including Articles 31 and 32 on matters of treaty interpretation, are declaratory of customary international law").

agreements with Belgium and Germany, primarily because the decision of the arbitration board is to be based upon a record rather than a presentation of evidence. Accordingly, it seemed more prudent in these cases to allow flexibility to the arbitration board to formulate procedural rules that might be necessary to its particular case. As experience is gained under the proposed agreements, we will consider whether more procedural guidance for the arbitration boards is necessary.

Question 10. Your office has discussed with the committee the possibility of concluding targeted tax protocols with other countries that would focus on problem areas, such as "treaty shopping." Can you tell us whether you anticipate concluding targeted protocols that would provide for binding arbitration? If so, with which countries should the United States seek to conclude such targeted protocols?

Answer. In general, we strongly prefer that a protocol to amend an existing tax treaty address all pressing issues with respect to the treaty relationship. However, if there is an urgent matter that can be resolved by entering into a protocol, and no other urgent matters need to be resolved in an existing tax treaty, a targeted protocol may be appropriate. "Treaty shopping" is the clearest example of an instance in which a targeted protocol may be appropriate. With respect to binding arbitration, if there were an immediate need to provide competent authority with this tool for resolving disputes with a particular country, and if there were no other urgent issues to update, we would consider pursuing a targeted protocol.

Question 11. In the dividend, interest, and royalty articles of the 2006 U.S. Model Tax Treaty, the phrase "effectively connected with" is used when referring to the level of attachment that the underlying property must have with a permanent establishment for purposes of determining whether the dividend, interest, and royalty articles apply, or whether Article 7 will apply instead. This phrase replaces the 1996 Model Tax Treaty phrase "attributable to." The Belgium Tax Treaty currently pending on the committee's calendar, uses the new model language ("effectively connected with") in all three of those articles. The dividend article of the Belgium Tax Treaty currently in force uses the language "forms part of the business property of the permanent establishment." Are there substantive differences between (a) that language, (b) "attributable to," and (c) "effectively connected with" (and if so, what are the differences)?

Answer. The United States has used these three formulations interchangeably. See, for example, the language of Article 10(6) of the 1996 Model Income Tax Convention (which uses the "attributable to" formulation) and the 1996 model technical explanation to Article 10(6) (which explains the "attributable to" language by using the words "forms part of the business property of the permanent establishment"). The 2006 U.S. Model Income Tax Convention adopts the "effectively connected with" formulation, bringing the U.S. Model Income Tax Convention language in closer conformity with standard tax treaty usage. See, for example, the OECD and U.N. models. The concepts and coverage of these three formulations are intended to be the same.

Question 12. Section 6103 of the Internal Revenue Code generally prohibits the disclosure of tax returns and other tax return information with certain narrow exceptions. In fact, the willful violation of this section and the disclosure of such information is punishable as a felony. The concerns that prompted this law are also relevant in the context of any arbitration proceedings that may occur pursuant to the German Protocol or Belgium Tax Treaty, since individuals under those circumstances will also have access to personal taxpayer information that would otherwise be covered by section 6103. Can you explain how the Department intends to protect against the disclosure of tax returns and other tax return information during the course of arbitration proceedings? Both treaties provide that all members of the arbitration boards and their staffs are to agree to abide by, and be subject to, specific confidentiality and nondisclosure requirements and any applicable domestic laws of the treaty countries involved. Can the Department enforce criminal charges against board members or staff who improperly disclose information in violation of such agreements and domestic law requirements if they are not U.S. citizens or employees of the U.S. Government and remain outside of the United States?

Answer. Both the German protocol and the Belgian tax treaty provide that no information relating to an arbitration proceeding may be disclosed by members of the arbitration board or their staffs, or by either competent authority, except as permitted by treaty and the domestic laws of the Contracting States. In addition, both agreements provide that all information relating to the arbitration proceeding is to be considered to be information exchanged between the Contracting States (that is, information subject to the provisions of the exchange of information article regarding disclosure). The German protocol and the Belgian tax treaty further provide that

all members of the arbitration board and their staffs must agree in statements sent to each of the Contracting States in confirmation of their appointment to the arbitration board to abide by and be subject to the confidentiality and nondisclosure provisions of the exchange of information article and the applicable domestic laws of the Contracting States, with the most restrictive condition to apply in the event of a conflict.

The German protocol and the Belgian tax treaty authorize the competent authorities to develop rules and procedures to conduct arbitration proceedings. Pursuant to that authorization, the U.S. competent authority and its counterparts in Germany and Belgium will develop the details of the contractual arrangement between the competent authorities and the members of an arbitration board. We expect this arrangement to take the form of a memorandum of understanding (MOU) between the competent authorities and the members of the arbitration board. Pursuant to such MOU, the engagement of members of arbitration boards will be structured within the framework of section 6103(n) of the Internal Revenue Code, which authorizes the disclosure of returns and return information in connection with the contractual procurement of services for purposes of tax administration. Persons to whom returns or return information are disclosed under the authority of section 6103(n) are prohibited under section 6103(a) from redisclosing such taxpayer information and are subject to the full range of statutory penalties and remedies provided for unauthorized disclosures (see, for example, sections 7213 and 7431 of the Internal Revenue Code). Pursuant to Treasury regulations promulgated under section 6103(n), a contract between the Internal Revenue Service and a person to whom returns or return information may be disclosed under section 6103(n) is required to contain detailed conditions and provisions with respect to safeguarding such returns or return information. These conditions and provisions include specific requirements regarding data protection and security as well as a requirement that the contractor provide written notice to its officers and employees of the statutory penalties that will apply in the event of any further disclosure by the officer or employee. MOUs with the members of arbitration boards constituted pursuant to the German protocol and the Belgian tax treaty would accordingly include such conditions and provisions.

Under section 7213 of the Internal Revenue Code, the willful unauthorized disclosure of returns or return information is a criminal offense. It is anticipated that MOUs with the members of arbitration boards constituted pursuant to the German protocol and the Belgian tax treaty will include provisions requiring the members of the arbitration board to submit to the jurisdiction of a U.S. court. Such jurisdiction would also enable taxpayers to pursue civil actions for damages against an arbitration board member, under section 7431 of the Internal Revenue Code, for the willful or negligent unauthorized disclosure of returns or return information.

Question 13. What are the most significant barriers created by tax systems that still remain to cross-border investment? To what extent will these issues be addressed in future tax treaties?

Answer. The Treasury Department examines the U.S. tax treaty network on an ongoing basis to determine where significant barriers to cross-border investment exist.

With respect to countries with which we do not have a tax treaty, the most significant barriers to cross-border investment are typically high withholding tax rates and instances in which the United States and the other country disagree as to which country has primary taxing rights (e.g., the two countries disagree as to source of the income or the residence of the taxpayer). Negotiation of a tax treaty, if possible, would reduce those barriers. The Treasury Department, therefore, works to establish new treaty relationships in order to reduce withholding rates, facilitate cross-border business activity, and provide mechanisms for collaboration between tax authorities in order to minimize double taxation.

With respect to countries with which we have a tax treaty, the existing tax treaty may have withholding tax rates higher than the U.S. model rates or the existing tax treaty may have become outdated due to changes in U.S. or foreign law or treaty policy, inadvertently creating obstacles to cross-border investment. In those cases, the Treasury Department seeks to renegotiate treaties to reduce withholding rates, update the provisions in the treaty, and reduce double taxation by improving coordination between tax authorities.

At the same time, as we negotiate to reduce barriers, we also negotiate to improve information exchange relationships and to prevent treaty shopping and other tax treaty abuse.

Question 14. Do you believe that these tax treaties will have any impact on worker flow between the United States and any of these countries?

Answer. One of the goals of a tax treaty is to reduce tax-related impediments to the mobility of labor to enable companies to employ U.S. workers overseas on a competitive basis. U.S. tax treaties contain several provisions that generally enhance the mobility of U.S. individuals, including rules that set thresholds for foreign taxation of U.S. individuals working abroad and rules that mitigate the potential double taxation consequences of U.S. taxation of U.S. citizens and residents on their worldwide income. Tax treaties also typically provide rules to coordinate the tax treatment of pension plans, and the agreements with Germany and Belgium further provide rules coordinating deductibility of cross-border pension contributions. Accordingly, we believe that these agreements, especially the Germany protocol and the Belgium tax treaty, will provide greater flexibility to U.S. individuals who seek to work in those countries.

Question15. What are the criteria used to determine if a particular country is a suitable candidate for updating a tax treaty, or negotiating a new one, with the United States?

Answer. The United States enters into tax treaties to resolve issues of double or excessive taxation, and to permit proper administration of U.S. tax law. To identify potential treaty partners, the Treasury Department relies heavily on input from the U.S. business community about particular countries and circumstances in which U.S. investments are being subjected to double or excessive taxation.

For updating an existing tax treaty, the primary issues are the extent to which the existing tax treaty is out of date and the likelihood of obtaining favorable changes to the existing tax treaty.

For entering into negotiations with a country with which we do not have a tax treaty, the primary issues are the extent of double or excessive taxation, the extent to which a tax treaty would be able to address those problems, and whether the possible treaty partner can agree to provisions necessary to the United States. With some countries (e.g., a country that does not impose significant income taxes), a tax treaty will not be appropriate, either because of the possibility of abuse of the treaty or because of the lack of cross-border tax issues that are best resolved by a tax treaty. In addition, if a potential treaty partner cannot agree to appropriate exchange of information provisions or limitation on benefits provisions or insists on terms (such as tax-sparing) that we cannot accept, it will not be fruitful to enter into negotiations. Often, preliminary meetings are necessary to determine whether a particular country would be an appropriate partner to a tax treaty.

Question 16. Last year, this committee and the full Senate approved tax treaties with Sweden, France, and Bangladesh. Can you explain how these agreements have affected trade and investment between the United States and each of these countries?

Answer. The impact of tax treaties on trade and investment is difficult to measure. In addition, given that the protocols with Sweden and France were merely updates to existing treaties, the effects on trade and investment of those agreements may be even more difficult to assess. We believe that all three agreements have encouraged greater trade and investment with the United States. At the same time, we recognize the Joint Committee on Taxation's assessment that the larger macroeconomic outlook will have a greater impact on future cross-border trade and investment than the tax treaties will.

Question 17. With which other countries are treaties or protocols currently being negotiated and what are the anticipated timelines for completion?

Answer. An agreement with Bulgaria was signed in February 2007. The Treasury Department has also recently reached agreements with Canada, Iceland, and Norway, and all three agreements are going through the necessary process to prepare them for signature.

The Treasury Department continues to prioritize its efforts to update the few remaining U.S. tax treaties that provide for low withholding tax rates but do not include the limitation on benefits provisions needed to protect against the possibility of treaty shopping. In furtherance of this goal, we have scheduled negotiations with Hungary and Poland.

In addition, the Treasury Department is negotiating agreements with Chile and the Republic of Korea. We are also undertaking exploratory discussions with several countries in Asia and South America that we hope will lead to productive negotiations later this year or next year.

Completion of all of these negotiations will be dependent on reaching agreement on a number of key issues, which differ for each negotiation. As a result, it is difficult to provide an anticipated timeline for completion. However, we hope to conclude these agreements as soon as possible.

CLARIFICATION RESPONSE BY JOHN HARRINGTON TO QUESTION 9(I) FROM SENATOR BIDEN

Question. One of the questions posed after the July 17 hearing, Question 9(i), related to the arbitration provisions that are included in both the German and Belgian Tax Treaties. Specifically, the question focused on the fact that the interpretive rules to be applied by an arbitration board are not fully consistent with the interpretive rules laid out in Articles 31 and 32 of the Vienna Convention on the Law of Treaties, which reflect customary international law regarding treaty interpretation.

The question posed was—given the inconsistency—"might you consider [in future treaties with arbitration clauses] referring to the Vienna Convention rules for treaty interpretation, rather than the list provided for in the German and Belgian Treaties?" The United States would, as a matter of international law, apply the Vienna Convention rules on treaty interpretation unless the treaty itself dictated otherwise, and thus, it would seem sensible to have the arbitration board do the same.

In response to the question, you stated as follows:

> The list of authorities in the proposed agreements reflects the documents that the U.S. competent authority has found most useful in its own tax treaty interpretation. However, we will continue to monitor the process and search for ways to increase its effectiveness, keeping in mind customary international law rules of treaty interpretation as reflected in the Vienna Convention, including an assessment of the utility of the list of authorities.

While the list of authorities in the two treaties may be useful in interpreting tax treaty terms, this answer is not fully responsive to the question and suggests that you do not view Articles 31 and 32 of the Vienna Convention on the Law of Treaties as reflecting the rule under which tax treaties are interpreted.

Do you view the customary international law rules of treaty interpretation reflected in the Vienna Convention as applicable to tax treaties?

If the answer to this question is "no," please explain why and state your view of the applicable rule for interpreting tax treaties.

Answer. Yes. In the absence of an agreement to the contrary by the States Parties concerned, the United States generally views the customary international law rules of treaty interpretation, as reflected in the Vienna Convention on the Law of Treaties, as applicable to treaties, including tax treaties. The arbitration provisions in the proposed agreements with Germany and Belgium contain references to many interpretive materials that would be considered under the relevant provisions of the Vienna Convention on the Law of Treaties. The types of interpretive materials referenced in the proposed agreements with Germany and Belgium, along with the technical explanations prepared by the Treasury Department and other documents submitted to the Senate as part of the ratification process, generally inform the U.S. view of the meaning of tax treaties. As we move forward on arbitration provisions in future agreements, we are considering appropriate means to reflect customary international law rules of treaty interpretation.

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