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TAX CONVENTION WITH SLOVENIA

NOVEMBER 3, 1999.—Ordered to be printed

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

REPORT

[To accompany Treaty Doc. 106–9]

The Committee on Foreign Relations, to which was referred the Convention between the United States of America and the Republic of Slovenia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, signed at Ljubljana on June 21, 1999, having considered the same, reports favorably thereon, with one reservation, one understanding, one declaration and one proviso, and recommends that the Senate give its advice and consent to ratification thereof, as set forth in this report and the accompanying resolution of ratification.

CONTENTS

		Page
I.	Purpose	1
II.	Background	2
III.	Summary	2
IV.	Entry Into Force and Termination	3
V.	Committee Action	3
VI.	Committee Comments	3
VII.	Budget Impact	11
VIII.	Explanation of Proposed Treaty	11
IX.	Text of the Resolution of Ratification	50

I. PURPOSE

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

It also is intended to enable the two countries to cooperate in preventing avoidance and evasion of taxes.

II. BACKGROUND

The proposed treaty was signed on June 21, 1999. No income tax treaty between the United States and Slovenia is in force at present.

The proposed treaty was transmitted to the Senate for advice and consent to its ratification on September 13, 1999 (see Treaty Doc. 106–9). The Committee on Foreign Relations held a public hearing on the proposed treaty on October 27, 1999.

III. SUMMARY

The proposed treaty is similar to other recent U.S. income tax treaties, the 1996 U.S. model income tax treaty ("U.S. model"), and the model income tax treaty of the Organization for Economic Cooperation and Development ("OECD model"). However, the proposed treaty contains certain substantive deviations from those treaties and models.

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. For example, the proposed treaty contains provisions under which each country generally agrees not to tax business income derived from sources within that country by residents of the other country unless the business activities in the taxing country are substantial enough to constitute a permanent establishment or fixed base (Articles 7 and 14). Similarly, the proposed treaty contains "commercial visitor" exemptions under which residents of one country performing personal services in the other country will not be required to pay tax in the other country unless their contact with the other country exceeds specified minimums (Articles 14, 15, and 17). The proposed treaty provides that dividends, interest, royalties, and certain capital gains derived by a resident of either country from sources within the other country generally may be taxed by both countries (Articles 10, 11, 12, and 13); however, the rate of tax that the source country may impose on a resident of the other country on dividends, interest, and royalties generally will be limited by the proposed treaty (Articles 10, 11, and 12).

In situations where the country of source retains the right under the proposed treaty to tax income derived by residents of the other country, the proposed treaty generally provides for relief from the potential double taxation through the allowance by the country of residence of a tax credit for certain foreign taxes paid to the other country (Article 23).

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 in the case of the United States) as if the treaty had not come into effect (Article 1). 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 contains certain "main purpose" tests which operate to deny the benefits of the dividends article (Article 10), the interest article (Article 11), the royalties article (Article 12) and the other income article (Article 21) if the main purpose or one of the main purposes of a person is to take advantage of the benefits of the respective article through a creation or assignment of shares, debt claims, or rights that would give rise to income to which the respective article would apply.

The proposed treaty also contains a detailed limitation on benefits provision to prevent the inappropriate use of the treaty by third-country residents (Article 22).

IV. Entry Into Force and Termination

A. ENTRY INTO FORCE

The proposed treaty will enter into force upon the exchange of instruments of ratification. With respect to taxes withheld at source, the proposed treaty takes effect for amounts paid or credited on or after the first day of the third month following the date on which the proposed treaty enters into force. With respect to other taxes, the proposed treaty takes effect for taxable periods beginning on or after the first of January following the date on which the proposed treaty enters into force.

B. TERMINATION

The proposed treaty will continue in force until terminated by either country. Either country may terminate the proposed treaty by giving notice of termination to the other country through diplomatic channels. With respect to taxes withheld at source, a termination is effective for amounts paid or credited after the expiration of the six month period beginning on the date on which notice of termination was given. In the case of other taxes, a termination is effective for taxable periods beginning on or after the expiration of the six month period beginning on the date on which notice of termination was given.

V. Committee Action

The Committee on Foreign Relations held a public hearing on the proposed treaty with Slovenia (Treaty Doc. 106–9), as well as on other proposed treaties and protocols, on October 27, 1999. The hearing was chaired by Senator Hagel. The Committee considered these proposed treaties and protocols on November 3, 1999, and ordered the proposed treaty with Slovenia favorably reported by a voice vote, with the recommendation that the Senate give its advice and consent to ratification of the proposed treaty, subject to a reservation, an understanding, a declaration, and a proviso.

VI. Committee Comments

On balance, the Committee on Foreign Relations believes that the proposed treaty with Slovenia is in the interest of the United States and urges that the Senate act promptly to give advice and

consent to ratification. The Committee has taken note of certain issues raised by the proposed treaty, and believes that the following comments may be useful to the Treasury Department officials in providing guidance on these matters should they arise in the course of future treaty negotiations.

A. MAIN PURPOSE TESTS

In general

The proposed treaty includes a series of "main purpose" tests that can operate to deny the benefits of the dividends article (Article 10), the interest article (Article 11), the royalties article (Article 12), and the other income article (Article 21). This series of main purpose tests is not found in any other U.S. treaty, and is not included in the U.S. model or the OECD model.[1]

Description of provisions

Under the proposed treaty, the provisions of the dividends article (Article 10) will not apply if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the shares or rights in respect of which the dividend is paid to take advantage of the dividends article by means of that creation or assignment. Similarly, the interest article (Article 11) provides that its provisions will not apply if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the debt claim in respect of which the interest is paid to take advantage of the interest article by means of that creation or assignment. Substantially similar main purpose tests apply in the case of the royalties article (Article 12) and the other income article (Article 21).

The Technical Explanation indicates that the main purpose tests are to be "self-executing." The Technical Explanation further states that the tax authorities of one of the treaty countries may, on review, deny the benefits of the respective article if the conditions of the main purpose tests are satisfied. In addition, the proposed treaty provides that under the mutual agreement procedures article (Article 25) the competent authorities of the treaty countries may agree that the conditions for application of the main purpose tests are met. The Technical Explanation states that the competent authority agreement does not have to relate to a particular case. Rather, if the competent authorities agree that a type of transaction entered into by several taxpayers is entered into with a main purpose of taking advantage of the treaty, treaty benefits can be denied to all taxpayers who had entered into such a transaction. The Technical Explanation states that it is anticipated that the public would be notified of such generic agreements through the issuance of press releases.

[1] Although not included in the OECD model, paragraph 17 of the commentary to the dividends article of the OECD model suggests that the treaty partners may find it appropriate to adopt a rule to deny treaty benefits if the acquisition of stock was "primarily for the purpose of taking advantage of this provision."

Committee concerns with the "main purpose" tests

The Committee has several concerns with the new main purpose tests. The inclusion of such tests in the specific articles of the proposed treaty represents a fundamental shift in U.S. treaty policy. As a general matter, such changes in policy should be made only after careful consideration of whether circumstances warrant such a change, and whether the proposed change is appropriate. The Treasury Department should engage in meaningful consultations with the Congress when proposing to make such a policy shift. The Committee is concerned that such consultations did not occur in this instance, and that the Committee has not been afforded an opportunity to weigh the relevant policy considerations (including whether a need for such a provision exists) and to evaluate alternative approaches with respect to the proposed new tests.

The Treasury Department has acknowledged that the United States presently has the right to apply its domestic law (including anti-abuse principles such as the business purpose doctrine) in the treaty context; this is a broad authority that would allow treaty benefits to be denied in tax avoidance transactions. The Treasury Department has stated, however, that the proposed main purpose tests are intended to go beyond present U.S. domestic law. Although the Committee shares the Treasury Department's concern with abusive transactions, the Treasury Department has not convinced the Committee that a higher standard is necessary in U.S. treaties than that which applies under domestic law. In addition, the Committee is concerned that the Treasury Department has not adequately explained the potential implications of going beyond present U.S. law in the treaty context.

The new main purpose tests in the proposed treaty are subjective, vague and add uncertainty to the treaty. It is unclear how the provisions are to be applied. In addition, the provisions lack conformity with other U.S. tax treaties. This uncertainty could create difficulties for legitimate business transactions, and can hinder a taxpayer's ability to rely on the treaty.

In the past, the United States has determined that subjective tests are not appropriate in the treaty context. For example, older U.S. treaties containing limitation on benefits provisions (which address an abuse of a treaty whereby residents of third countries try to take advantage of the treaty provisions through what is known as treaty shopping) applied broad subjective tests looking to whether the acquisition, maintenance, or operation of an entity did not have "as a principal purpose obtaining benefits under" the treaty. These subjective tests have been replaced in recent treaties (including the proposed treaty) with limitation on benefits provisions that apply clear, bright-line objective tests (such as ownership and base erosion tests, public company tests, as well as active business tests). The reasons for moving away from subjective standards are illustrated by a statement in the Technical Explanation to the limitation on benefits provision of the proposed treaty that acknowledges in connection with a principal purpose test that a "fundamental problem presented by this approach is that it is based on the taxpayer's motives in establishing an entity in a particular country, which a tax administrator is normally ill-equipped to identify." Although this criticism is specific to a principal purpose test

with respect to an anti-treaty shopping provision, the same concern applies with respect to subjective tests in general.

The main purpose standard in the relevant provisions of the proposed treaty is that "the main purpose or one of the main purposes" is to "take advantage of" the particular article in which the main purpose tests appear. This is a subjective standard, dependent upon the intent of the taxpayer, that is difficult to evaluate. Such a standard is inconsistent with present U.S. treaty policy. In addition, the Committee is concerned that a broad standard based on whether one of the main purposes of a taxpayer is to take advantage of a particular treaty provision does not adequately distinguish between legitimate business transactions and tax avoidance transactions. While it is true that under U.S. domestic law, "a principal purpose" test is used as an anti-abuse rule in a variety of contexts, its use generally has been limited to circumscribed situations. The Committee is concerned that the circumstances for inclusion of a main purpose test in the proposed treaty are not well-defined and that the standard potentially has much broader implications in the treaty context then in its analogs under U.S. domestic law. The Committee believes that consideration should be given to alternative formulations of anti-abuse standards, including objective standards such as those contained in the limitation on benefits provisions of modern U.S. income tax treaties.

It is also unclear how the proposed the main purpose tests would be administered. The Technical Explanation indicates that the tests are intended to be self-executing. In the absence of a taxpayer applying the tests to itself, the tax authorities of one of the countries may, on review, deny the treaty benefits. The Committee is concerned that the Treasury Department has not provided adequate assurances that the tests will not be used by treaty partners to deny treaty benefits for legitimate business activity.

A fairness question also may be raised insofar as the proposed treaty provides the competent authorities with the ability to declare an entire class of transactions as abusive and, accordingly, deny treaty benefits to that class without the necessity of evaluating the facts of each specific transaction. It is unclear what degree of deference would be accorded to such a competent authority agreement by responsible tax administrative authorities or by the courts. Moreover, because the main purpose tests do not appear in other U.S. treaties or with respect to other articles of this proposed treaty, an issue arises as to whether its inclusion in specific provisions of this proposed treaty creates a negative inference as to the United States' ability to raise its internal anti-abuse rules in connection with other treaties (or other provisions of this proposed treaty) in which such main purpose tests do not appear. The Technical Explanation states that no such inference with respect to other treaties is intended. The Committee believes that further consideration and analysis of these issues are necessary.

Committee conclusions

The Committee shares the Treasury Department's concerns with respect to abusive transactions that inappropriately take advantage of treaty benefits. The Committee does not believe, however, that the main purpose tests in the proposed treaty have been fully and

adequately developed. The Committee believes that there are many issues, including the need for such tests and, if needed, what the appropriate tests should be as a matter of U.S. treaty policy, that must be addressed before it would be appropriate to include such provisions in any U.S. income tax treaty. Accordingly, the Committee has included in its recommended resolution of ratification a reservation requiring that the main purpose tests be stricken from the proposed treaty.

Notwithstanding the Committee's concerns with the main purpose tests in the proposed treaty and its recommendation of a reservation in this regard, on balance the Committee believes that the proposed treaty with Slovenia is in the interest of the United States and strongly urges the Treasury Department to pursue an exchange of instruments of ratification with the aforementioned reservation with the same zeal with which it negotiated the proposed treaty in the first instance.

In addition, the Committee is committed to working with the Treasury Department to develop appropriate ways to address tax avoidance in the treaty context. The Committee requests that the Treasury Department provide it with a comprehensive analysis of (1) the need for a main purpose or similar test including specific examples of abusive transactions that cannot be adequately addressed under present U.S. law; (2) alternatives to such a test including alternatives that rely on objective standards; (3) the interaction of such a test with present domestic law and the corresponding rules under the relevant foreign law; (4) any potential inferences that may be created with respect to other U.S. treaties and other provisions of the specific treaty that do not contain such a test; (5) the expected standards of judicial review with respect to the application of such a test and the degree of deference that may be accorded to competent authority agreements with respect to such a test; (6) the experience of foreign countries that presently include such a test or similar tests in their income tax treaties; and (7) any other relevant considerations.

Until these issues have been fully considered by both the Treasury Department and the Committee, the Committee strongly recommends that the Treasury Department not modify its model treaty to include these or similar main purpose tests and not include such main purpose tests or similar tests in future treaties.

B. EXCHANGE OF INFORMATION

One of the principal purposes of the proposed treaty between the United States and Slovenia is to prevent avoidance or evasion of taxes of the two countries. The exchange of information article of the proposed treaty (Article 26) is one of the primary vehicles used to achieve that purpose.

The exchange of information article contained in the proposed treaty generally conforms to the corresponding article of the OECD model and the U.S. model. As is true under these model treaties, under the proposed treaty a country is not required to carry out administrative measures at variance with the laws and administrative practice of either country, to supply information that is not obtainable under the laws or in the normal course of the administration of either country, or to supply information that discloses any

trade, business, industrial, commercial, or professional secret or trade process, or information the disclosure of which is contrary to public policy.

The exchange of information article contained in the proposed treaty varies significantly from the U.S. model in one respect: the authority to obtain information from third parties (commonly referred to as the "bank secrecy" provision). This provision of the U.S. model provides that, notwithstanding the limitations described in the preceding paragraph, a country has the authority to obtain and provide information held by financial institutions, nominees, or persons acting in a fiduciary capacity. This information must be provided to the requesting country notwithstanding any laws or practices of the requested country that would otherwise preclude acquiring or disclosing such information.

One issue the Committee has considered is the significance of the omission of this provision with respect to this proposed treaty. The Technical Explanation to Article 26 notes the omission of this provision. The Technical Explanation states that:

> The United States has received assurances from the Slovenian Ministry of Finance concerning Slovenia's ability to exchange third-party information obtained from banks and other financial institutions (hereinafter referred as "banks"). Specifically, Article 30 of Slovenia's Law on Tax procedures allows Slovenia to obtain from banks any and all information relevant to assessment and collection of taxes, whether the information pertains to the party under investigation or another party involved in the tax matter. Article 26 of this law also imposes on banks and savings banks an obligation to send without specific request to the tax authorities information about accounts which are held by individuals and legal persons and information about transactions through these accounts.

The Treasury Department has received a letter dated June 14, 1999, from the Ministry of Finance of the Republic of Slovenia containing these assurances. Because of the Committee's view as to the vital nature of these exchanges of third-party information, the Committee has conditioned ratification of the proposed treaty on the following understanding, which shall be included in the instrument of ratification, and shall be binding on the President:

> EXCHANGE OF INFORMATION.—The United States understands that, pursuant to Article 26 of the Convention, both the competent authority of the United States and the competent authority of the Republic of Slovenia have the authority to obtain and provide information held by financial institutions, nominees or persons acting in an agency or fiduciary capacity, or respecting interests in a person.

Another issue the Committee has considered is the implications of the omission of this provision from this treaty with respect to future treaty negotiations. While some treaty partners do not object to this bank secrecy provision, other treaty partners have resisted its inclusion in tax treaties. The broader issue of transparency of transactions involving third parties is a significant issue internationally. The United States has attempted to advance greater

transparency in its treaty negotiations. It is possible that the omission of the bank secrecy provision from this treaty may be interpreted by other treaty partners as a weakening of the U.S. commitment to greater transparency and may make other treaty negotiations with respect to this issue more difficult. The Committee intends that the omission of this provision from this treaty does not indicate in any way a lessening of the commitment of the United States to pursue broader exchanges of information in future treaty negotiations.

The Committee would have serious concerns with respect to a proposed treaty if the other country restricted access to this information and were unwilling to change its internal laws to accommodate full exchanges of information. The exchange of information provisions in treaties are central to the purposes for which tax treaties are entered into, and significant limitations on their effect, relative to the preferred U.S. tax treaty position, should not be accepted in negotiations with other countries that seek to have or maintain the benefits of a tax treaty relationship with the United States.

The Committee understands that the Treasury Department has stated that other countries have expressed "diplomatic" concerns regarding the bank secrecy provision in the current U.S. model. While the Committee is sensitive to these concerns, the Committee is at the same time fully committed to full exchanges of information with other treaty partners. The Committee understands that the Treasury Department may be considering removing this bank secrecy provision from the U.S. model. The Committee believes that, while revisions to that provision might be appropriate, it is vital that future tax treaties (as well as the U.S. model) retain explicit language providing for full exchanges of information, including exchanges of information held by third parties. The Committee expects that the Treasury Department will consult fully with the Committee prior to any modification of the U.S. model relating to this issue.

C. TREATY SHOPPING

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

The anti-treaty-shopping provision of the proposed treaty is similar to anti-treaty-shopping provisions in the Code (as interpreted by Treasury regulations) and in the U.S. model. The provision also is similar to the anti-treaty-shopping provision in several recent treaties. The degree of detail included in these provisions is notable in itself. The proliferation of detail may reflect, in part, a diminution in the scope afforded the IRS and the courts to resolve interpretive issues adversely to a person attempting to claim the benefits of a treaty; this diminution represents a bilateral commitment, not alterable by developing internal U.S. Tax policies, rules, and procedures, unless enacted as legislation that would override the treaty. (In contrast, the IRS generally is not limited under the proposed treaty in its discretion to allow treaty benefits under the anti-treaty-shopping rules.) The detail in the proposed treaty does represent added guidance and certainty for taxpayers that may be absent under treaties that may have somewhat simpler and more flexible provisions.

One provision of the anti-treaty-shopping-article differs from the comparable rule of some earlier U.S. treaties, but the effect of the change is not clear. The general test applied by those treaties to allow benefits to an entity that does not meet the bright-line ownership and base erosion tests is a broadly subjective one, looking to whether the acquisition, maintenance, operation of an entity did not have "as a principal purpose obtaining benefits under" the treaty. By contrast, the proposed treaty contains a more precise test that allows denial of benefits only with respect to income not derived in connection with (or incidental to) the active conduct of a substantial trade or business. (However, this active trade or business test does not apply with respect to a business of making or managing investments carried on by a person other than a bank, insurance company, or registered securities dealer, so benefits may be denied with respect to such a business regardless of how actively it is conducted). In addition, the proposed treaty (like all recent treaties) gives the competent authority of the country in which the income arises the authority to determine that the benefits of the treaty will be granted to a person even if the specified tests are not satisfied.

The practical difference between the proposed treaty tests and the corresponding tests in other treaties will depend upon how they are interpreted and applied. Given the relatively bright line rules provided in the proposed treaty, the range of interpretation under it may be fairly narrow.

The Committee believes that limitation on benefits provisions are important to protect against "treaty shopping" by limiting benefits of a treaty to bona fide residents of the treaty partner. The Committee further believes that the United States should maintain its policy of limiting treaty shopping opportunities whenever possible. The Committee continues to believe further that, in exercising any latitude the Treasury Department has to adjust the operation of the proposed treaty, the rules as applied should adequately deter treaty shopping abuses. The proposed anti-treaty-shopping provision may be effective in preventing third-country investors from obtaining treaty benefits by establishing investing entities in Slovenia because third-country investors may be unwilling to allow 50

percent or more of such investing entities to be owned by U.S. or Slovenian residents or other qualified owners in order to meet the ownership test of the anti-treaty-shopping provision. In addition, the base erosion test provides protection from certain potential abuses of a Slovenian conduit. On the other hand, implementation of the tests for treaty shopping set forth in the treaty may raise factual, administrative, or other issues that cannot currently be foreseen. The Committee emphasizes that the proposed anti-treaty-shopping provision must be implemented so as to serve as an adequate tool for preventing possible treaty shopping abuses in the future.

VII. Budget Impact

The Committee has been informed by the staff of the Joint Committee on Taxation that the proposed treaty is estimated to cause a negligible change in fiscal year Federal budget receipts during the 1999–2008 period.

VIII. Explanation of Proposed Treaty

A detailed, article-by-article explanation of the proposed income tax treaty between the United States and Slovenia is set forth below.

Article 1. General Scope

Overview

The general scope article describes the persons who may claim the benefits of the proposed treaty. It also includes a "saving clause" provision similar to provisions found in most U.S. income tax treaties.

The proposed treaty generally applies to residents of the United States and to residents of Slovenia, with specific modifications to such scope provided in other articles (*e.g.*, Article 24 (Non-Discrimination) and Article 26 (Exchange of Information and Administrative Assistance)). This scope is consistent with the scope of other U.S. income tax treaties, the U.S. model, and the OECD model. For purposes of the proposed treaty, residence is determined under Article 4 (Residence).

The proposed treaty provides that it does not restrict in any manner any exclusion, exemption, deduction, credit, or other allowance or benefit accorded by internal law or by any other agreement between the United States and Slovenia. Thus, the proposed treaty will not apply to increase the tax burden of a resident of either the United States or Slovenia. According to the Treasury Department's Technical Explanation (hereinafter referred to as the "Technical Explanation"), the fact that the proposed treaty only applies to a taxpayer's benefit does not mean that a taxpayer may select inconsistently among treaty and internal law provisions in order to minimize its overall tax burden. In this regard, the Technical Explanation sets forth the following example. Assume a resident of Slovenia has three separate businesses in the United States. One business is profitable and constitutes a U.S. permanent establishment. The other two businesses generate taxable income under the Internal Revenue Code (the "Code"), but do not constitute perma-

nent establishments as determined under the proposed treaty; one business is profitable and the other business generates a net loss. Under the Code, all three businesses would be subject to U.S. income tax, in which case the losses from the unprofitable business could offset the taxable income from the other businesses. On the other hand, only the income of the business which gives rise to a permanent establishment is taxable by the United States under the proposed treaty. The Technical Explanation makes clear that the taxpayer may not invoke the proposed treaty to exclude the profits of the profitable business that does not constitute a permanent establishment and invoke U.S. internal law to claim the loss of the unprofitable business that does not constitute a permanent establishment to offset the taxable income of the permanent establishment.[2]

The proposed treaty provides that the dispute resolution procedures under its mutual agreement article take precedence over the corresponding provisions of any other agreement to which the United States and Slovenia are parties in determining whether a measure is within the scope of the proposed treaty. Unless the competent authorities determine that a taxation measure is outside the scope of the proposed treaty, only the proposed treaty's non-discrimination rules, and not the non-discrimination rules of any other agreement in effect between the United States and Slovenia, generally apply to that law or other measure. The only exception to this general rule is such national treatment or most favored nation obligations as may apply to trade in goods under the General Agreement on Tariffs and Trade. For purposes of this provision, the term "measure" means a law, regulation, rule, procedure, decision, administrative action, or any other form of measure.

Saving clause

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

The proposed treaty contains a provision under which the saving clause (and therefore a country's jurisdiction to tax) applies to a former citizen or long-term resident whose loss of citizenship had as one of its principal purposes the avoidance of tax as defined under the laws of the country of which the person was a citizen or long-term resident; such application is limited to the ten-year period following the loss of citizenship. Section 877 of the Code provides special rules for the imposition of U.S. income tax on former U.S. citizens and long-term residents for a period of ten years following the loss of citizenship or resident status; these special tax

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

rules apply to a former citizen or long-term resident only if his or her loss of U.S. citizenship or resident status had as one of its principal purposes the avoidance of U.S. income, estate or gift taxes. For purposes of applying the special tax rules to former citizens and long-term residents, individuals who meet a specified income tax liability threshold or a specified net worth threshold generally are considered to have lost citizenship or resident status for a principal purpose of U.S. tax avoidance.

Exceptions to the saving clause are provided for the following benefits conferred by a treaty country: the allowance of correlative adjustments when the profits of an associated enterprise are adjusted by the other country (Article 9, paragraph 2); the exemption from residence country tax for social security benefits and certain child support payments (Article 18, paragraphs 2 and 5); relief from double taxation through the provision of a foreign tax credit (Article 23); protection from discriminatory tax treatment with respect to transactions with residents of the other country (Article 24); and benefits under the mutual agreement procedures (Article 25). These exceptions to the saving clause permit residents and citizens of the United States or Slovenia to obtain such benefits of the proposed treaty with respect to their country of residence (or citizenship).

In addition, the saving clause does not apply to the following benefits conferred by one of the countries upon individuals who neither are citizens of that country nor have immigrant status in that country. Under this set of exceptions to the saving clause, the specified treaty benefits are available to, for example, a Slovenian citizen who spends enough time in the United States to be taxed as a U.S. resident but who has not acquired U.S. immigrant status (*i.e.*, does not hold a "green card"). The benefits that are covered under this set of exceptions are the exemptions from host country tax for certain compensation from government service (Article 19), certain income received by students, trainees, professors and researchers (Article 20), and certain income of diplomats and consular officers (Article 27).

Article 2. Taxes Covered

The proposed treaty generally applies to the income taxes of the United States and Slovenia. However, Article 24 (Non-Discrimination) is applicable to all taxes imposed at all levels of government, including state and local taxes. Moreover, Article 26 (Exchange of Information and Administrative Assistance) generally is applicable to all national-level taxes, including, for example, estate and gift taxes.

In the case of the United States, the proposed treaty applies to the Federal income taxes imposed by the Code, but excludes social security taxes. The proposed treaty also applies to the Federal excise taxes imposed with respect to private foundations.

In the case of Slovenia, the proposed treaty applies to the tax on profits of legal persons; the tax on income of individuals, including wages and salaries, income from agricultural activities, income from business, capital gains and income from immovable and movable property; and the assets tax on banks and savings institutions.

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

Article 3. General Definitions

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

The term "person" includes an individual, an estate, a trust, a partnership, a company, and any other body of persons. A "company" under the proposed treaty is any body corporate or any entity which is treated as a body corporate for tax purposes according to the laws of the country in which it is organized.

The terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean, respectively, an enterprise carried on by a resident of a treaty country and an enterprise carried on by a resident of the other treaty country. The proposed treaty does not define the term "enterprise." The Technical Explanation states that the term "enterprise" generally is understood to refer to any activity or set of activities that constitute a trade or business.

The proposed treaty defines "international traffic" as any transport by a ship or aircraft except when the transport is solely between places in a treaty country. Accordingly, with respect to a Slovenian enterprise, purely domestic transport within the United States does not constitute "international traffic." The Technical Explanation states that transportation that constitutes international traffic includes any portion of the transport that is between two points within a country, even if the internal portion of the transport involves a transfer to a land vehicle or is handled by an independent carrier (provided that the original bills of lading include such portion of such transport).

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

The term "United States" means the United States of America, and includes the States, the District of Columbia, and the territorial sea of the United States; it also includes the seas, seabed and subsoil of the submarine areas adjacent to the territorial sea over which the United States has sovereign rights in accordance with

international law. The term does not include, however, Puerto Rico, the Virgin Islands, Guam, or any other U.S. possession or territory. The Technical Explanation states that the sea bed and subsoil of undersea areas adjacent to the territorial sea of the United States are included only to the extent that the person, property, or activity to which the proposed treaty is being applied is connected with the exploration or exploitation of natural resources.

The term "Slovenia" means the Republic of Slovenia, as well as the territorial sea, sea bed, and subsoil adjacent to the territorial sea over which Slovenia, in accordance with international law and its domestic legislation, exercises its sovereign rights or jurisdiction.

Under the proposed treaty, a person is a "national" of one of the treaty countries if the person is an individual possessing nationality or citizenship of that country or is a legal person, partnership or association deriving its status as such from the laws in force in that country.

The term "qualified governmental entity" under the proposed treaty means any person or body of persons that constitutes a governing body of one of the treaty countries, or a political subdivision or local authority of the country. It also includes a person that is wholly owned, directly or indirectly, by one of the treaty countries or a political subdivision or local authority of the country. Such a wholly-owned person, however, is only a qualified governmental entity if it is organized under the laws of the treaty country; its earnings are credited to its own account with no portion of its income inuring to the benefit of any private person; and its assets vest in the treaty country (or its political subdivision or local authority) upon dissolution—provided that such wholly-owned entity does not carry on commercial activities. A qualified governmental entity also includes a pension or trust fund of a person described above and that is constituted and operated exclusively to administer or provide pension benefits described in the government service article (Article 19), provided that the pension or trust fund does not carry on commercial activities.

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

Article 4. Residence

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

Internal taxation rules

United States

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

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

Slovenia

Under Slovenian law, resident individuals are subject to tax on their worldwide income, while nonresident individuals are subject to tax only on certain income derived in Slovenia. An individual who is present in Slovenia for at least 183 consecutive days in a calendar year is considered a resident for tax purposes. Individuals who are present in Slovenia for a period of less than 183 consecutive days in a calendar year are nonresidents for tax purposes and are taxable in Slovenia only on Slovenian-source taxable income.

Under Slovenian law, resident legal entities and companies generally are subject to tax on their worldwide income. Nonresident legal entities generally are subject to Slovenian tax only on income attributable to a permanent establishment (within the meaning of Slovenian law) in Slovenia and on income attributable to any agents of the foreign company entitled to conclude contracts on its behalf (other than contracts for the mere purchase of products or services). A company or legal entity is a nonresident if it does not have its head office in Slovenia

Proposed treaty rules

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

The proposed treaty generally defines "resident of a Contracting State" to mean any person who, under the laws of that country, is liable to tax in that country by reason of the person's domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature. The proposed treaty provides that a U.S. citizen or alien lawfully admitted to the United States for permanent residence (a "green card" holder) will be treated as a U.S. resident only if such person has a substantial presence, permanent home or habitual abode in the United States. The term "resident of a Contracting State" does not include any person that is liable to tax in that country only on income from sources in that country or capital situated in that country or profits attributable to a permanent establishment in that country.

The proposed treaty provides a special rule for fiscally transparent entities. Under this rule, the income of a partnership, estate, or trust is considered to be a resident of one of the treaty countries only to the extent that the income it derives is subject to tax in that country as the income of a resident, either in its hands or in the hands of its partners, beneficiaries, members, or grantors. The Technical Explanation states that this includes a U.S. limited liability company that is classified as a partnership for U.S. tax purposes. Under this provision, for example, if the U.S. partners' share of the income of a U.S. partnership is only one-half, the proposed treaty's limitations on withholding tax rates would apply to only one-half of the Slovenian source income paid to the partnership. Under Slovenian law, all entities are subject to tax at the entity level and, accordingly, this aspect of the proposed treaty has no effect as applied to Slovenian entities.

The proposed treaty also provides a special rule to treat as residents of a treaty country certain organizations that generally are exempt from tax in that country. Under this rule, certain organizations that are established and maintained in a country exclusively for religious, charitable, educational, scientific or similar purposes or to provide pension or similar benefits to employees pursuant to a plan are treated as residents of that country, notwithstanding that all or part of its income may be exempt from tax under the domestic law of that country.

Qualified governmental entities (as defined in Article 3(1)(i)) are treated as residents of the countries in which they are established for purposes of the proposed treaty.

A set of "tie-breaker" rules is provided to determine residence in the case of an individual who, under the basic residence definition, would be considered to be a resident of both countries. Under these rules, an individual is deemed to be a resident of the country in which he or she has a permanent home available. If the individual has a permanent home in both countries, the individual's residence is deemed to be the country with which his or her personal and economic relations are closer (*i.e.*, his or her "center of vital interests"). If the country in which the individual has his or her center of vital interests cannot be determined, or if he or she does not have a permanent home available in either country, he or she is deemed to be a resident of the country in which he or she has an habitual abode. If the individual has an habitual abode in both countries or in neither country, he or she is deemed to be a resident of the country of which he or she is a national. If the individual is a national of both countries or neither country, the competent authorities of the countries will settle the question of residence by mutual agreement.

A company that would be a resident of both countries under the basic definition in the proposed treaty is deemed to be a resident of the country in which it is created or organized. If the company is dual-incorporated, then the company will be treated as a resident of one of the countries only if and to the extent that the competent authorities can agree to a single country of residence for the company. In the case of any other persons other than individuals or companies (such as trusts or estates) that would be a resident of both countries under the basic definition in the proposed treaty,

the proposed treaty requires the competent authorities to settle the issue of residence by mutual agreement and to determine the mode of application of the proposed treaty to such person.

Article 5. Permanent Establishment

The proposed treaty contains a definition of the term "permanent establishment" that generally follows the pattern of the U.S. model and the OECD model.

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

In general, under the proposed treaty, a permanent establishment is a fixed place of business through which the business of an enterprise is wholly or partly carried on. A permanent establishment includes a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources. It also includes a building site or a construction or installation project, or an installation or drilling rig or ship used for the exploration of natural resources, if the site, project, or activities continue for more than twelve months. The Technical Explanation states that the twelve-month test applies separately to each individual site or project, with a series of contracts or projects that are interdependent both commercially and geographically treated as a single project. The Technical Explanation further states that if the twelve-month threshold is exceeded, the site or project constitutes a permanent establishment as of the first day that work in the country began. The U.S. and OECD models contain similar rules (except for the absence in the OECD model of a rule for drilling rigs).

Under the proposed treaty, the following activities are deemed not to constitute a permanent establishment: the use of facilities solely for storing, displaying, or delivering goods or merchandise belonging to the enterprise; the maintenance of a stock of goods or merchandise belonging to the enterprise solely for storage, display, or delivery or solely for processing by another enterprise; the maintenance of a fixed place of business solely for the purchase of goods or merchandise or for the collection of information for the enterprise; and the maintenance of a fixed place of business solely for the purpose of carrying on for the enterprise any other activity of a preparatory or auxiliary character. The Technical Explanation gives advertising or the supply of information as examples of such preparatory and auxiliary activities.

Under the proposed treaty, as under the U.S. model, the maintenance of a fixed place of business solely for any combination of the above-listed activities does not constitute a permanent establishment. The proposed treaty does not contain the OECD model's qualification that a fixed place of business used solely for any com-

bination of these activities does not constitute a permanent establishment, provided that the overall activity of the fixed place of business is of a preparatory or auxiliary character. In this regard, the Technical Explanation states that it is the United States position that a combination of activities that are each preparatory or auxiliary activities always will result in an overall activity that is also preparatory or auxiliary.

Under the proposed treaty, if a person, other than an independent agent, is acting on behalf of an enterprise and has, and habitually exercises in a country, the authority to conclude contracts that are binding on such enterprise, the enterprise is deemed to have a permanent establishment in that country in respect of any activities undertaken for that enterprise. This rule does not apply where the contracting authority is limited to the activities listed above, such as storage, display, or delivery of merchandise, which are excluded from the definition of a permanent establishment.

Under the proposed treaty, no permanent establishment is deemed to arise if the agent is a broker, general commission agent, or any other agent of independent status, provided that the agent is acting in the ordinary course of its business. The Technical Explanation states that whether an enterprise and an agent are independent is a factual determination; relevant factors include the extent to which the agent operates based on instructions from the enterprise, which party bears the business risk associated with the agent's activities on behalf of the enterprise, and whether the agent has an exclusive or nearly exclusive relationship with the principal.

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

Article 6. Income from Real Property (Immovable Property)

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

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

The term "real property" ("immovable property") has the meaning which it has under the law of the country in which the property in question is situated.[3] The proposed treaty specifies that the term in any case includes property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property, and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources, and other natural resources. Ships, boats, and aircraft are not considered to be immovable property.

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

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

Like the U.S. model and certain other U.S. income tax treaties, the proposed treaty provides residents of a country with an election to be taxed on a net basis by the other country on income from real property in that other country. Such election is binding for the taxable year and all subsequent taxable years unless the competent authority of the country where the real property is located agrees to terminate the election. U.S. internal law provides such a net-basis election in the case of income from a foreign person from U.S. real property. (Code secs. 871(d) and 882(d)).

Article 7. Business Profits

Internal taxation rules

United States

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

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

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

Special rules apply for purposes of determining the foreign-source income that is effectively connected with a U.S. business of an insurance company.

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

Slovenia

Nonresident legal entities (*i.e.*, companies or entities that do not have their head office in Slovenia) generally are subject to Slovenian tax only on income attributable to a permanent establishment (within the meaning of Slovenian law) in Slovenia, on income attributable to any agents of the foreign company entitled to conclude contracts on its behalf (other than contracts for the mere purchase of products or services), and on Slovenian-source dividends. Nonresident individuals generally are subject to Slovenian tax only on Slovenian-source income.

Proposed treaty limitations on internal law

Business profits subject to host country tax

Under the proposed treaty, business profits of an enterprise of one of the countries are taxable in the other country only to the extent that they are attributable to a permanent establishment in the other country through which the enterprise carries on business. This is one of the basic limitations on a country's right to tax income of a resident of the other country. The rule is similar to those contained in the U.S. and OECD models.

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

The proposed treaty provides that there will be attributed to a permanent establishment the business profits which it might be expected to make if it were a distinct and independent entity engaged in the same or similar activities under the same or similar conditions. The Technical Explanation explains that this incorporates the arm's-length standard for purposes of determining the profits attributable to a permanent establishment. The Technical Explanation further states that it is understood that this provision permits the use of methods other than separate accounting to deter-

mine the arm's-length profits of a permanent establishment where it is necessary to do so for practical reasons, such as when the affairs of the permanent establishment are so closely bound up with those of the head office that it would be impossible to disentangle them on any strict basis of accounts.

Treatment of expenses

In computing taxable business profits, the proposed treaty provides that deductions are allowed for expenses, wherever incurred, which are incurred for the purposes of the permanent establishment. These deductions include a reasonable allocation of executive and general administrative expenses, research and development expenses, interest, and other expenses incurred for purposes of the enterprise as a whole (or, if not the enterprise as whole, at least the part of the enterprise that includes the permanent establishment). According to the Technical Explanation, under this language, each treaty country is permitted to (but not required to) apply the type of expense allocation rules provided by U.S. law (such as Treas. Reg. secs. 1.861–8 and 1.882–5). Thus, for example, a Slovenian company that has a branch office in the United States but which has its head office in Slovenia may, in computing the U.S. tax liability, be entitled to deduct a portion of the executive and general administrative expenses incurred in Slovenia by the head office for purposes of operating the U.S. branch, allocated and apportioned in accordance with Treas. Reg. sec. 1.861–8 (or 1.882–5). The Committee believes that it is appropriate to apply reasonable allocation methods for these purposes. In addition, the Technical Explanation states that this rule does not permit a deduction for expenses charged to a permanent establishment by another unit of the enterprise. Thus, a permanent establishment may not deduct a royalty deemed paid to the head office.

Other rules

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

The amount of profits attributable to a permanent establishment must be determined by the same method each year unless there is good and sufficient reason to change the method. The Technical Explanation states that this rule does not restrict a treaty country from imposing additional requirements, such as the rules under Code section 481, to prevent amounts from being duplicated or omitted following a change in accounting method.

The proposed treaty provides that the business profits attributed to a permanent establishment shall include only the profits derived from the assets or activities of the permanent establishment. The proposed treaty does not incorporate the limited force of attraction rule of Code section 864(c)(3). The proposed treaty is consistent with the U.S. model treaty and other existing U.S. treaties in this regard.

Where business profits include items of income that are dealt with separately in other articles of the proposed treaty, those other articles, and not the business profits article, govern the treatment of those items of income (except where such other articles specifically provide to the contrary). Thus, for example, dividends are taxed under the provisions of Article 10 (Dividends), and not as business profits, except as specifically provided in Article 10.

The proposed treaty follows the U.S. model and defines the term "business profits" broadly to mean income derived from any trade or business, including income derived from the performance of personal services and from the rental of tangible property.

The proposed treaty also provides that, for purposes of the taxation of business profits, income or gain may be attributable to a permanent establishment or fixed base (and therefore may be taxable in the country where the permanent establishment or fixed base was situated) even if the payment of such income is deferred until after the permanent establishment or fixed base has ceased to exist. This rule incorporates into the proposed treaty the rule of Code section 864(c)(6). The rule applies with respect to business profits (Article 7, paragraphs 1 and 2), dividends (Article 10, paragraph 6), interest (Article 11, paragraph 5), royalties (Article 12, paragraph 4), gains (Article 13, paragraph 3), independent personal services (Article 14), and other income (Article 21, paragraph 2).

Article 8. Shipping and Air Transport

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

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

Under the proposed treaty, profits which are derived by an enterprise of one country from the operation in international traffic of ships or aircraft are taxable only in that country, regardless of the existence of a permanent establishment in the other country. "International traffic" means any transport by a ship or aircraft, except where the transport is solely between places in the other country (Article 3(1)(d) (General Definitions)).

The proposed treaty provides that profits from the rental of ships or aircraft on a full (time or voyage) basis constitute profits from the operation of ships or aircraft. Thus, such profits from the rental of ships or aircraft for use in international traffic are exempt from tax in the other country. In addition, the proposed treaty provides that profits from the operation of ships or aircraft include profits derived from the rental of ships or aircraft on a bareboat basis if the ships or aircraft are operated in international traffic by the lessee, or if such rental profits are incidental to other profits of the lessor from the operation of ships or aircraft in international traf-

fic. Thus, the exemption from source-country tax for shipping profits applies to a bareboat lessor (such as a financial institution or a leasing company) that does not operate ships or aircraft in international traffic, but that leases the ships or aircraft for use in international traffic. In addition, profits derived by an enterprise from the inland transport of property or passengers within a country are treated as profits from the operation of ships or aircraft in international traffic if such transport is undertaken as part of international traffic by the enterprise. These rules are the same as the rules in the U.S. model.

Like the U.S. model, the proposed treaty provides that profits of an enterprise of a country from the use, maintenance, or rental of containers (including trailers, barges, and related equipment for the transport of containers) used in international traffic is exempt from tax in the other country.

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

Article 9. Associated Enterprises

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

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

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

According to the Technical Explanation, it is understood that this article does not replace the internal law provisions that permit this type of adjustment. Adjustments are permitted under internal law

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

Article 10. Dividends

Internal taxation rules

United States

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

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

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

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

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

come of the same type as the underlying earnings. Such distributions are subject to the U.S. 30-percent withholding tax when paid to foreign owners.

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

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

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

Slovenia

Slovenia generally imposes a withholding tax on dividend payments to nonresident legal entities and individuals at a rate of 15 percent.

Proposed treaty limitations on internal law

Under the proposed treaty, dividends paid by a resident of a treaty country to a resident of the other country may be taxed in such other country. Dividends paid by a resident of a treaty country to a resident of the other country may also be taxed by the country in which the payor is resident, but the rate of such tax is limited. Under the proposed treaty, source-country taxation (*i.e.*, taxation by the country in which the payor is resident) generally is limited to 5 percent of the gross amount of the dividend if the beneficial owner of the dividend is a company which owns at least 25 percent of the voting shares of the payor company (or, in the case of Slovenia, if there is no voting stock, at least 25 percent of the statutory capital of the payor company). The source country dividend withholding tax generally is limited to 15 percent of the gross amount of the dividends beneficially owned by residents of the other country in all other cases.

The rates of source country dividend withholding tax permitted under the proposed treaty are the same as those provided for in the U.S. model and the OECD model, but the ownership requirement generally follows the OECD model. The proposed treaty provides that these rules do not affect the taxation of the payor company on the profits out of which the dividends are paid.

The proposed treaty allows the United States to impose a 15-percent tax on a U.S.-source dividend paid by a RIC to a Slovenian person. The proposed treaty allows the United States to impose a 15-percent tax on a U.S.-source dividend paid by a REIT to a Slovenian person if: (1) the beneficial owner of the dividend is an individual holding an interest of not more than 10 percent of the REIT; (2) the dividend is paid with respect to a class of stock that is publicly traded and the beneficial owner of the dividend is a person holding an interest of not more than 5 percent of any class of the REIT's stock; or (3) the beneficial owner of the dividend is a person holding an interest of not more than 10 percent of the REIT and the REIT is diversified. There is no limitation in the proposed treaty on the tax that may be imposed by the United States with respect to a REIT dividend that does not satisfy at least one of these requirements. Thus, such a dividend is taxable at the 30-percent U.S. statutory withholding rate. For purposes of this provision, the Technical Explanation states that a REIT will be considered to be diversified if the value of no single interest in the REIT's real property exceeds 10 percent of the REIT's total interests in real property.

Like the U.S. model, the proposed treaty exempts dividends paid to qualified governmental entities (that do not control the payor) from tax in the treaty country of source. This provision is analogous to the exemption provided to foreign governments under section 892 of the Code and makes that exemption reciprocal.

The proposed treaty provides a definition of "dividends" that is broad and flexible and generally follows the U.S. model. The proposed treaty generally defines "dividends" as income from shares or other rights which participate in profits and which are not debt claims. The term also includes income from other corporate rights if such income is subjected to the same tax treatment by the country in which the distributing corporation is resident as income from shares.

The proposed treaty's reduced rates of tax on dividends do not apply if the beneficial owner of the dividend carries on business through a permanent establishment (or a fixed base, in the case of an individual who performs independent personal services) in the source country and the dividends are attributable to the permanent establishment (or fixed base). Such dividends are taxed as business profits (Article 7) or as income from the performance of independent personal services (Article 14), as the case may be. In addition, dividends attributable to a permanent establishment or fixed base, but received after the permanent establishment or fixed base is no longer in existence are taxable in the country where the permanent establishment or fixed base existed (Article 7, paragraph 8).

The proposed treaty contains a general limitation on the taxation by a treaty country of dividends paid to a resident of the other country by a corporation that is not a resident of the first country

(a so-called "second-level withholding tax"). Under this provision, a treaty country may not impose any tax on dividends paid by a corporation that is resident in the other country except where the dividends are paid to a resident of the first country, or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or fixed base of the recipient in the first country.

The proposed treaty permits the imposition of a branch profits tax, but limits the rate of such tax to five percent. In the case of the United States, the branch profits tax may be imposed on a corporation resident in Slovenia to the extent of the corporation's (1) business profits that are attributable to a permanent establishment in the United States, (2) income that is subject to taxation on a net basis because the corporation has elected under section 882(d) of the Code to treat income from real property not otherwise taxed on a net basis as effectively connected income and (3) gain from the disposition of certain U.S. real property interests. Such tax may be imposed only on the portion of the business profits attributable to such permanent establishment, or the portion of such real property income or gains, that represents the "dividend equivalent amount." The Technical Explanation states that the term "dividend equivalent amount" has the same meaning as it has under section 884 of the Code (as it may be amended).

The proposed treaty provides a "main purpose" test that is not specifically included in the dividends articles of the U.S. model or OECD model. Under this rule, the proposed treaty's reduced rates of tax on dividends do not apply if the main purpose, or one of the main purposes, for the creation or assignment of shares or other rights in respect of which dividends are paid is to take advantage of the dividends article of the proposed treaty. The Technical Explanation states that it is intended that the provisions of this article will be self-executing, but the tax authorities of one of the treaty countries, on review, may deny the benefits of the reduced rate of tax on dividends. In addition, the Technical Explanation states that the competent authorities of both of the treaty countries may together agree that this standard has been met in a particular case or with respect to a type of transaction entered into by a number of taxpayers.

Article 11. Interest

Internal taxation rules

United States

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

tion; under this rule, an amount equal to the excess of the interest deduction allowed with respect to the U.S. business over the interest paid by such business is treated as if paid by a U.S. corporation to a foreign parent and therefore is subject to the 30-percent withholding tax.

Portfolio interest generally is defined as any U.S.-source interest that is not effectively connected with the conduct of a trade or business if such interest (1) is paid on an obligation that satisfies certain registration requirements or specified exceptions thereto and (2) is not received by a 10-percent owner of the issuer of the obligation, taking into account shares owned by attribution. However, the portfolio interest exemption does not apply to certain contingent interest income.

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

Slovenia

Slovenia does not generally impose a withholding tax on Slovenian-source interest paid to nonresidents legal entities. Slovenia does, however, impose a withholding tax at a rate of 25 percent when the payment is from a Slovenian legal entity to a nonresident individual.

Proposed treaty limitations on internal law

The proposed treaty provides that interest arising in one of the countries and paid to a resident of the other country generally may be taxed by both countries. This is contrary to the position of the U.S. model which provides for an exemption from source-country tax for interest earned by a resident of the other country, but not unlike other U.S. treaties with developing countries.

The proposed treaty limits the rate of source-country tax that may be imposed on interest income. Under the proposed treaty, if the beneficial owner of interest is a resident of the other country, the source-country tax on such interest generally may not exceed five percent of the gross amount of such interest.

The proposed treaty provides for a complete exemption from source-country withholding tax in the case of certain categories of interest earned by residents of the other country. Interest arising in one of the treaty countries and paid to a qualified government entity is exempt from source-county tax, provided that the qualified governmental entity does not control the person paying the inter-

est. Moreover, interest arising in either country in connection with a debt obligation that is guaranteed or insured by a qualified governmental entity of the other country is exempt from source-country tax. In addition, the proposed treaty exempts from source-country tax interest paid or accrued with respect to a deferred payment for personal property (movable property) or services.

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

In the case of the United States, the proposed treaty permits limited source-country taxation of the excess, if any, of (1) the amount of interest borne by a permanent establishment, fixed base, or trade or business subject to tax on a net basis with respect to real property income or gains, over (2) the interest paid by that permanent establishment, fixed base or trade or business in the United States. This rule allows the United States to impose its branch-level excess interest tax; however, such tax may be imposed only at the treaty rate applicable to interest payments (*i.e.*, five percent).

The proposed treaty's reductions in source-country tax on interest do not apply if the beneficial owner carries on business in the source country through a permanent establishment located in that country and the interest is attributable to that permanent establishment. In such an event, the interest is taxed as business profits (Article 7). The proposed treaty's reduced rates of tax on interest also do not apply if the interest recipient is a resident of a treaty country who performs independent personal services in the other treaty country from a fixed base located in the other country and such interest is attributable to the fixed base. In such a case, the interest attributable to the fixed base is taxed as income from the performance of independent personal services (Article 14). The Technical Explanation states that these rules also apply if the permanent establishment or fixed base no longer exists when the interest is paid but such interest is attributable to the former permanent establishment or fixed base.

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

dend under local law and thus be subject to the provisions of Article 10 (Dividends). The provision of the proposed treaty does not address cases in which the amount of interest is less than an arm's-length amount. The Technical Explanation states that in those cases, a transaction may be characterized to reflect its substance and interest may be imputed.

The proposed treaty provides two anti-abuse exceptions to the general source-country reduction in tax discussed above. The first exception relates to "contingent interest" payments. If interest is paid by a source-country resident to a resident of the other country and is determined with reference (1) to receipts, sales, income, profits, or other cash flow of the debtor or a related person, (2) to any change in the value of any property of the debtor or a related person, or (3) to any dividend, partnership distribution, or similar payment made by the debtor to a related person, such interest may be taxed in the source country in accordance with its internal laws. However, if the beneficial owner is a resident of the other country, such interest may not be taxed at a rate exceeding 15 percent (*i.e.*, the rate prescribed in subparagraph (b) of paragraph 2 of Article 10 (Dividends)). The second anti-abuse exception provides that the reductions in and exemption from source-country tax do not apply to excess inclusions with respect to a residual interest in a REMIC. Such income may be taxed in accordance with each country's internal law.

The proposed treaty provides that interest is treated as arising in a country if the payor is a resident of that country.[4] If, however, the interest expense is borne by a permanent establishment or a fixed base in a treaty country, the interest would have as its source the country in which the permanent establishment or fixed base is located, regardless of the residence of the payor. Thus, for example, if a French resident has a permanent establishment in Slovenia and that French resident incurs indebtedness to a U.S. person, the interest on which is borne by the Slovenian permanent establishment, the interest would be treated as having its source in Slovenia.

The proposed treaty also provides a main purpose test similar to that for dividends (Article 10) under which the provision with respect to interest will not apply if the main purpose, or one of the main purposes, for the creation or assignment of the debt claim in respect of which interest is paid is to take advantage of the interest article of the proposed treaty.

Article 12. Royalties

Internal taxation rules

United States

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

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

Slovenia

Slovenia does not generally impose a withholding tax on Slovenian-source royalties paid to nonresidents legal entities. Slovenia does, however, impose a withholding tax at a rate of 15 percent when the payment is from a Slovenian legal entity to a nonresident individual.

Proposed treaty limitations on internal law

The proposed treaty provides that royalties arising in a treaty country and paid to a resident of the other country may be taxed by that other country. In addition, the proposed treaty allows the country where the royalties arise to tax such royalties. However, if the beneficial owner of the royalties is a resident of the other country, the source-country tax generally may not exceed five percent of the gross royalties. The U.S. and OECD models generally exempt royalties from source-country taxation.

For purposes of this five-percent limitation, the term "royalties" means payment of any kind received as consideration for the use of, or the right to use, any copyright of literary, artistic, scientific or other work (including computer software, cinematographic films, audio or video tapes or disks, and other means of image or sound reproduction), any patent, trademark, design or model, plan, secret formula or process or other like right or property, or for information concerning industrial, commercial or scientific experience. The term also includes gains derived from the alienation of such rights or property or rights provided that such gains are contingent on the productivity, use, or disposition of such property. According to the Technical Explanation, it is understood that whether payments with respect to computer software are treated as royalties (or as business profits) will depend on the facts and circumstances of the particular transaction. The Technical Explanation also states that it is understood that payments with respect to transfers of "shrink wrap" computer software will be treated as business profits.

The proposed treaty rates with respect to royalties do not apply if the beneficial owner is an enterprise that carries on business through a permanent establishment in the source country, and the royalties are attributable to the permanent establishment. In that event, the royalties are taxed as business profits (Article 7). The proposed treaty's rates of tax on royalties also do not apply if the beneficial owner is a Slovenian resident who performs independent personal services in the United States from a fixed base located in the United States and such royalties are attributable to the fixed base. In such a case, the royalties attributable to the fixed base are taxed as income from the performance of independent personal services (Article 14). The Technical Explanation states that these rules also apply if the permanent establishment or fixed base no longer exists when the royalties are paid but such royalties are attributable to the former permanent establishment or fixed base.

The proposed treaty addresses the issue of non-arm's-length royalties between related parties (or parties otherwise having a special relationship) by providing that the amount of royalties for purposes of applying this article is the amount that would have been agreed upon by the payor and the beneficial owner in the absence of the special relationship. Any amount of royalties paid in excess of such

amount is taxable according to the laws of each country, taking into account the other provisions of the proposed treaty. For example, excess royalties paid by a subsidiary corporation to its parent corporation may be treated as a dividend under local law and thus be subject to the provisions of Article 10 (Dividends).

The proposed treaty provides special source rules for royalties which are not included in the U.S. model. Royalties are deemed to arise within a country if the payor is that country, including its political or administrative subdivisions and local authorities, or a resident of that country. If, however, the royalty expense is borne by a permanent establishment (or fixed base) that the payor has in Slovenia or the United States, the royalty has as its source the country in which the permanent establishment (or fixed base) is located, regardless of the residence of the payor. Thus, for example, if a French resident has a permanent establishment in Slovenia and that French resident pays a royalty to a U.S. person which is attributable to the Slovenian permanent establishment, then the royalty would be treated as having its source in Slovenia. The proposed treaty provides that notwithstanding the foregoing rules, royalties with respect to the use of, or right to use, rights or property within a treaty county may be deemed to arise within that country. Thus, consistent with U.S. internal law, the United States may treat royalties with respect to the use of property in the United States as U.S. source income.

As in the case of dividends (Article 10) and interest (Article 11), the proposed treaty includes a main purpose test under which the royalty provision will not apply if the main purpose, or one of the main purposes, for the creation or assignment of rights in respect of which royalties are paid is to take advantage of the proposed treaty's royalty article.

Article 13. Gains

Internal taxation rules

United States

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

Slovenia

Under Slovenian law, with respect to legal entities, gain from the sale of a capital asset generally is treated as ordinary business income and subject to tax at the regular corporate rates. Nonresident legal entities would be subject to tax by Slovenia on Slovenian-source capital gains and on capital gains attributable to a permanent establishment in Slovenia. Nonresident individuals are sub-

ject to tax on Slovenian-source capital gains to the extent that such gains would be taxable if the individual were a resident of Slovenia. Capital gains for this purpose include gains from the sale of real estate if the real estate is sold within three years from the date of acquisition, and securities and other shares in capital.

Proposed treaty limitations on internal law

The proposed treaty specifies rules governing when a country may tax gains from the alienation of property by a resident of the other country. The rules are generally consistent with those contained in the U.S. model.

Under the proposed treaty, gains derived by a resident of one treaty country from the alienation of real property situated in the other country may be taxed in the country where the property is situated. In addition, gains derived by a resident of one country from the alienation of an interest in a partnership, trust, or estate, to the extent attributable to real property situated in the other country, may be taxed in the country where the property is situated. For the purposes of this article, real property in the other country includes (1) real property as defined in Article 6 (Income from Real Property (Immovable Property)) situated in the other country, (2) an interest in a partnership, trust, or estate, to the extent that its assets consist of real property situated in that other country, and (3) shares or other comparable rights, other than shares that are regularly traded on an established securities market, in a company that is a resident of a treaty country and that derives at least 50 percent of its value directly or indirectly from immovable property situated in the other treaty country. The Technical Explanation states that this provision is intended to cover U.S. real property interests as well as any similar interests in Slovenian real property. The Technical Explanation also states that the United States will look through distributions made by a REIT and treat those distributions as gains subject to this article when they are attributable to gains derived from the alienation of real property.

Gains from the alienation of personal property (movable property) that form a part of the business property of a permanent establishment which an enterprise of one country has in the other country, gains from the alienation of movable property pertaining to a fixed base which is available to a resident of one country in the other country for the purpose of performing independent personal services, and gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or such a fixed base, may be taxed in that other country. The Treasury Explanation makes clear that this rule also applies if the permanent establishment or fixed base no longer exists when the gains are recognized but such gains relate to the former permanent establishment or fixed base.

Gains from the alienation of ships, aircraft, or containers operated in international traffic, (or movable property pertaining to the operation of ships, aircraft, or containers) are taxable only in the country in which the person disposing of such property is resident.

Gains from the alienation of any property other than that discussed above is taxable under the proposed treaty only in the country in which the person disposing of the property is resident.

Article 14. Independent Personal Services

Internal taxation rules

United States

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

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

Slovenia

Nonresident individuals generally are subject to tax on salaries or wages income earned under a contract for temporary work, and other income if the income is derived from services or work in the territory of Slovenia. Such income is taxed according to the same general rules and rates that apply to Slovenian residents.

Proposed treaty limitations on internal law

The proposed treaty limits the right of a country to tax income from the performance of personal services by a resident of the other country. Under the proposed treaty, income from the performance of independent personal services (*i.e.*, services performed as an independent contractor, not as an employee) is treated separately from income from the performance of dependent personal services.

Under the proposed treaty, income in respect of professional services or other activities of an independent character performed in one country by a resident of the other country is exempt from tax in the country where the services are performed (the source country), except that an individual may be taxed in the source country if he or she has a fixed base regularly available to him or her in that country for the purpose of performing the services.[5] In that case, the source country is permitted to tax only that portion of the individual's income which is attributable to the fixed base.

For purposes of this article of the proposed treaty, "professional services" includes especially independent scientific, literary, artistic, educational or teaching activities as well as independent activi-

[5] According to the Technical Explanation, it is understood that the concept of a fixed base is analogous to the concept of a permanent establishment.

ties of physicians, lawyers, engineers, architects, dentists, and accountants. This list is derived from the OECD model and, according to the Technical Explanation, is not exhaustive.

The principles of paragraph 3 of Article 7 (Business Profits) are applicable under the proposed treaty for determining taxable independent personal services income. Thus, according to the Technical Explanation, all relevant expenses, including expenses not incurred in the country in which the fixed base is located, must be allowed as deductions in computing independent personal services net income.

Article 15. Dependent Personal Services

Under the proposed treaty, wages, salaries, and other similar remuneration derived from services performed as an employee in one country (the source country) by a resident of the other country are taxable only by the country of residence if three requirements are met: (1) the individual must be present in the source country for not more than 183 days in any twelve-month period; (2) his or her employer must not be a resident of the source country; and (3) the compensation must not be borne by a permanent establishment or fixed base of the employer in the source country. These limitations on source-country taxation are identical to the rules of the U.S. model and the OECD model.

The proposed treaty provides that remuneration derived by a resident of one country in respect of employment as a member of the regular complement of a ship or aircraft operated in international traffic shall be taxable only by that country. This rule follows the U.S. model.

This article is subject to the provisions of the separate articles covering directors' fees (Article 16), pensions, social security benefits, annuities, alimony and child support (Article 18), and government service income (Article 19).

Article 16. Directors' Fees

Under the proposed treaty, directors' fees and other compensation derived by a resident of one country for services rendered in the other country as a member of the board of directors of a company which is a resident of that other country is taxable in that other country. This rule is the same as the corresponding rule in the U.S. model.

Article 17. Artistes and Sportsmen

Like the U.S. and OECD models, the proposed treaty contains a separate set of rules that apply to the taxation of income earned by entertainers (such as theater, motion picture, radio, or television "artistes" or musicians) and athletes. These rules apply notwithstanding the other provisions dealing with the taxation of income from personal services (Articles 14 and 15) and are intended, in part, to prevent entertainers and athletes from using the treaty to avoid paying any tax on their income earned in one of the countries.

Under the proposed treaty, income derived by an entertainer or athlete who is a resident of one country from his or her personal activities as such in the other country may be taxed in the other

country if the amount of the gross receipts derived by him or her from such activities (including reimbursed expenses) exceeds $15,000 or its Slovenian currency equivalent. Under this rule, if a Slovenian entertainer or athlete maintains no fixed base in the United States and performs (as an independent contractor) for one day of a taxable year in the United States for total compensation of $14,000, the United States could not tax that income. If, however, that entertainer's or athlete's total compensation were $16,000, the full amount would be subject to U.S. tax.

The proposed treaty provides that where income in respect of activities exercised by an entertainer or athlete in his or her capacity as such accrues not to the entertainer or athlete but to another person, that income is taxable by the country in which the activities are exercised unless it is established that neither the entertainer or athlete nor persons related to him or her participated directly or indirectly in the profits of that other person in any manner, including the receipt of deferred remuneration, bonuses, fees, dividends, partnership distributions, or other distributions. (This provision applies notwithstanding the business profits and personal service articles (Articles 7, 14, and 15).) This provision prevents highly-paid entertainers and athletes from avoiding tax in the country in which they perform by, for example, routing the compensation for their services through a third entity such as a personal holding company or a trust located in a country that would not tax the income.

The proposed treaty provides that these rules do not apply to income derived from activities performed in a country by entertainers or athletes if such activities are wholly or mainly supported by public funds of the other country or a political subdivision or a local authority thereof. In such a case, the income is taxable only in the entertainer's or athlete's country of residence. This rule is not contained in the U.S. or OECD models, but is contained in some other U.S. treaties.

Article 18. Pensions, Social Security, Annuities, Alimony, and Child Support

Under the proposed treaty, pensions and other similar remuneration beneficially owned by a resident of either country in consideration of past employment, whether paid periodically or in a lump sum, is taxable only in the recipient's country of residence; however, that country may not tax such income to the extent that it has already been included in taxable income in the other country prior to its distribution.

The proposed treaty provides that payments made by one of the countries under the provisions of the social security or similar legislation of the country to a resident of the other country or to a U.S. citizen are taxable only by the source country, and not by the country of residence. The Technical Explanation states that the term "similar legislation" is intended to include U.S. tier 1 Railroad Retirement benefits. Consistent with the U.S. model, this rule with respect to social security payments is an exception to the proposed treaty's saving clause.

The proposed treaty also provides that annuities are taxed only in the country of residence of the individual who beneficially owns

and derives them. The term "annuities" is defined for purposes of this provision as a stated sum paid periodically at stated times during a specified number of years, or for life, under an obligation to make the payments in return for adequate and full consideration (other than services rendered).

The proposed treaty also provides that alimony paid by a resident of one treaty country, and deductible in that country, to a resident of the other country are taxable only in the country of residence of the recipient. The term "alimony" for this purpose is defined as periodic payments made pursuant to a written separation agreement or decree of divorce, separate maintenance, or compulsory support and which are taxable to the recipient in its country of residence. In addition, the proposed treaty provides that periodic payments for child support made pursuant to a written separation agreement or decree of divorce, separate maintenance, or compulsory support, which are not otherwise alimony, are exempt from tax in both the United States and Slovenia. These rules are similar to the corresponding rules in the U.S. model.

Article 19. Government Service

Under the proposed treaty, wages and other remuneration, other than a pension, paid from the pubic funds of one of the countries (or a political subdivision or local authority thereof) to an individual in respect of services rendered to that country (or subdivision or authority) in the discharge of functions of a governmental nature generally is taxable only by that country. Such remuneration is taxable only in the other country, however, if the services are rendered in that other country by an individual who is a resident of that country and who (1) is also a national of that country or (2) did not become a resident of that country solely for the purpose of rendering the services. This treatment is consistent with the rules under the U.S. and OECD models.

The proposed treaty further provides that any pension paid from the public funds of one of the countries (or a political subdivision or local authority thereof) to an individual in respect of services rendered to that country (or subdivision or authority) in the discharge of functions of a governmental nature is taxable only by that country. Such a pension is taxable only by the other country, however, if the individual is a national and resident of that other country. This treatment is consistent with the rules under the U.S. and OECD models. When benefits paid by a country in respect of services rendered to that country are in the form of social security benefits, those payments are covered by paragraph 2 of the article dealing with pensions, social security and the like (Article 18).

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

The Technical Explanation clarifies that if a country or one of its political subdivisions or local authorities is carrying on business (as

opposed to functions of a governmental nature), the provisions of Articles 14 (Independent Personal Services), 15 (Dependent Personal Services), 16 (Directors' Fees), and 17 (Artistes and Sportsmen) apply to remuneration for services rendered in connection with the business.

Article 20. Students, Trainees, Professors and Researchers

Under the proposed treaty, a resident of a country that visits the other country (the host country) for the primary purpose of studying at a university or other recognized educational institution, securing training in a professional specialty, or studying or doing research as a recipient of a grant, allowance, or award from a governmental, religious, charitable, scientific, literary, or educational organization, is not taxable in the host country on certain items of income. Those exempt items include payments from abroad, other than compensation for personal services, for the purpose of maintenance, education, study, research or training; a grant, allowance or award; and income from personal services in the host country in an aggregate amount not in excess of $5,000 (or the equivalent in Slovenian tolars) for the taxable year involved. The exemptions are available for a period not exceeding five years from the beginning of the visit, and for such additional time as is necessary to complete, as a full time student, requirements to be a candidate for a postgraduate or professional degree from a recognized educational institution. The U.S. and OECD models also provide for some host-country exemptions for students and trainees. The U.S. model provides a time limit of one year for such exemption; there is no such time limit in the OECD model.

The proposed treaty also provides that a resident of a country who is employed or under contract with a resident of the same country and who temporarily visits the other country (the host country) for the primary purpose of acquiring technical, professional, or business experience from a person other than that other resident, or for studying at a university or other recognized educational institution in that other country is exempt from tax by the host country for a period not to exceed 12 months with respect to income from personal services in an aggregate amount not to exceed $8,000 (or the equivalent in Slovenian tolars).

Under the proposed treaty, an individual who is, or was immediately before visiting the host country, a resident of the other country and who is present in the host country for the purpose of teaching or engaging in research at a recognized educational or research institution is not taxable in the host country on his or her remuneration from personal services for teaching or research for a period not exceeding two years from the date of the individual's arrival in the host country. The proposed treaty provides that in no event will any individual have the benefits of this rule apply for more than five taxable years.

The proposed treaty provides that the special exemptions do not apply to income from research if such research is undertaken not in the public interest but primarily for the private benefit of a specific person or persons. This article of the proposed treaty is an exception from the saving clause in the case of persons who are neither citizens nor lawful permanent residents of the host country.

Article 21. Other Income

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

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

The general rule just stated does not apply to income (other than income from real property as defined in paragraph 2 of Article 6) if the beneficial owner of the income is a resident of one country and carries on business in the other country through a permanent establishment, or performs services in the other country from a fixed base, and the income is attributable to such permanent establishment or fixed base. In such a case, the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, will apply.

The proposed treaty contains a main purpose test similar to that provided with respect to the dividends, interest, and royalties articles (Articles 10, 11 and 12). The Technical Explanation states that, like those articles, the other income article is intended to be self-executing. However, the tax authorities, on review, may deny the benefits of the article in cases in which the main purpose, or one of the main purposes, for the creation or assignment of the rights in respect of which income is paid is to take advantage of the article.

Article 22. Limitation on Benefits

In general

The proposed treaty contains a provision generally intended to limit the indirect use of the proposed treaty by persons who are not entitled to its benefits by reason of residence in the United States or Slovenia.

The proposed treaty is intended to limit double taxation caused by the interaction of the tax systems of the United States and Slovenia as they apply to residents of the two countries. At times, however, residents of third countries attempt to use a treaty. This use is known as "treaty shopping," which refers to the situation in which a person who is not a resident of either treaty country seeks certain benefits under the income tax treaty between the two countries. Under certain circumstances, and without appropriate safeguards, the third-country resident may be able to secure these benefits indirectly by establishing a corporation or other entity in one of the treaty countries, which entity, as a resident of that country, is entitled to the benefits of the treaty. Additionally, it may be possible for the third-country resident to reduce the income base of the treaty country resident by having the latter pay out interest, royal-

ties, or other amounts under favorable conditions either through relaxed tax provisions in the distributing country or by passing the funds through other treaty countries until the funds can be repatriated under favorable terms.

Summary of proposed treaty provisions

The proposed anti-treaty shopping article provides that a resident of either Slovenia or the United States is entitled to the benefits of the treaty only to the extent provided in the article. To be entitled to the benefits of the treaty under the article, a resident of Slovenia or the United States must also be one of the following:

(1) an individual;

(2) a qualified governmental entity;

(3) a company that meets a public company test;

(4) a company that is owned by certain public companies;

(5) a tax-exempt entity organized exclusively for a religious, charitable, educational, scientific or other similar purpose;

(6) a tax-exempt entity that provides pension or other similar benefits to employees pursuant to a plan, provided that more than half of the beneficiaries, members, or participants are individual residents of the United States or Slovenia; or

(7) a person other than an individual that meets an ownership and base erosion test.

Alternatively, a resident that does not satisfy any of the above requirements may claim treaty benefits for particular items of income if it satisfies an active business test. In addition, a person that does not satisfy any of the above requirements may be granted the benefits of the proposed treaty if the competent authority of the country in which the income in question arises so determines.

Individuals

Under the proposed treaty, individual residents of one of the countries are entitled to all treaty benefits.

Qualified governmental entities

Under the proposed treaty, a qualified governmental entity is entitled to all treaty benefits. Qualified governmental entities include the governments of the two countries and political subdivisions and local authorities thereof. Qualified governmental entities also include certain wholly-owned entities, the earnings of which are credited to its own account with no portion of its income inuring to the benefit of any private person and the assets of which vest in the government upon dissolution, and certain pension trusts or funds providing government service pension benefits.

Public company tests

Under the proposed treaty, a company that is a resident of Slovenia or the United States and in which all the shares in the class or classes of shares that represent more than 50 percent of the voting power and value of such company are regularly traded on a "recognized stock exchange" is entitled to the benefits of the treaty regardless of where its actual owners reside or the amount or destination of payments it makes. Similarly, treaty benefits are available to a company if 50 percent or more of each class of shares in

the company is owned (directly or indirectly) by five or fewer companies that satisfy the public company test just described, provided that each company in the chain of ownership used to satisfy the control requirements is entitled to the treaty benefits. These rules follow the corresponding rules in the U.S. model.

The term "recognized stock exchange" means the NASDAQ System owned by the National Association of Securities Dealers, Inc.; any stock exchange registered with the Securities and Exchange Commission as a national securities exchange for the purposes of the Securities Exchange Act of 1934; the Ljubljana Stock Exchange; the stock exchanges of Frankfurt, London, Paris, and Vienna; and any other stock exchange agreed upon by the competent authorities of the two countries.

Tax-exempt organizations

Under the proposed treaty, entities that are resident in one of the treaty countries and that are exempt from tax in their country of residence and that are operated exclusively to fulfill religious, charitable, educational, scientific or other similar purposes are entitled to treaty benefits.

Pension funds

Under the proposed treaty, tax-exempt entities that are resident in one of the treaty countries and that provide pension or other similar benefits to employees pursuant to a plan are entitled to treaty benefits, provided that more than half of the beneficiaries, members or participants of the organization are individual residents of either country.

Ownership and base erosion tests

A legal entity that is a resident of Slovenia or the United States can be entitled to treaty benefits through satisfying an ownership and base erosion test. Both tests must be satisfied in order to qualify for treaty benefits under this criterion.

Under the ownership test, at least 50 percent of each class of shares or other beneficial interests in an entity must be owned, directly or indirectly (through a chain of ownership of persons entitled to treaty benefits), on at least half the days of the person's taxable year by one or more residents entitled to treaty benefits through satisfying the qualifications described above. That is, at least 50 percent of each class of shares or other beneficial interests is owned by residents of Slovenia or the United States that are individuals, qualified governmental entities, certain publicly traded companies or their subsidiaries (as described in the discussion of the public company tests above), certain tax-exempt organizations (as described in the discussion of tax-exempt entities above) or certain pension funds (as described in the discussion of pension funds above). This rule could, for example, deny the benefits of the reduced U.S. withholding tax rates on dividends and royalties paid to a Slovenian company that is controlled by individual residents of a third country. The ownership threshold in the proposed treaty follows the ownership threshold in the U.S. model.

The base erosion test is met only if the income of the entity is not used in substantial part, directly or indirectly, to meet liabil-

ities to persons or entities that are not residents of either treaty county. This rule is intended to prevent a corporation, for example, from distributing most of its income, in the form of deductible items such as interest, royalties, service fees, or other amounts to persons not entitled to benefits under the proposed treaty. Like the U.S. model, the proposed treaty provides that less than 50 percent of the person's gross income for the year can be paid or accrued (directly or indirectly) to persons who are not residents of the treaty countries in the form of payments that are deductible for income tax purposes in the person's country of residence. An exception is made for payments attributable to a permanent establishment in either country.

Active business test

Under the active business test, treaty benefits are available under the proposed treaty to an entity that is a resident of one of the treaty countries with respect to income from the other country if the entity is engaged in the active conduct of a trade or business in its residence country and the income is derived in connection with, or is incidental to, that trade or business. However, this does not apply (and benefits therefore may be denied) to the business of making or managing investments, unless these activities are banking, insurance or securities activities carried on by a bank, insurance company or registered securities dealer. In addition, the trade or business in the residence country must be substantial in relation to the activity in the other country from which it derives the income for which it is claiming treaty benefits.

Income is derived in connection with a trade or business if the activity in the other country generating the income is a line of business that forms a part of or is complimentary to the trade or business. Income is incidental to a trade or business if it facilitates the conduct of the trade or business in the other country.

The term "active conduct of a trade or business" is not specifically defined in the proposed treaty. However, as provided in Article 3 (General Definitions), undefined terms are to have the meaning which they have under the laws of the country applying the proposed treaty. In this regard, the Technical Explanation states that the U.S. competent authority will refer to the regulations issued under Code section 367(a) to define an active trade or business.

Grant of treaty benefits by the competent authority

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

Article 23. Relief from Double Taxation

Internal taxation rules

United States

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

Slovenia

Slovenia uses a tax credit system to avoid double taxation under which payments of foreign tax with respect to foreign-source income may be credited against the Slovenian tax due.

Proposed treaty limitations on internal law

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

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

The proposed treaty generally provides that the United States will allow a U.S. citizen or resident a foreign tax credit for the income taxes imposed by Slovenia. The proposed treaty also requires the United States to allow a deemed-paid credit, with respect to Slovenian income tax, to any U.S. company that receives dividends from a Slovenian company if the U.S. company owns 10 percent or more of the voting stock of such Slovenian company. The credit generally is to be computed in accordance with the provisions and subject to the limitations of U.S. law (as such law may be amended from time to time without changing the general principles of the proposed treaty provisions). This provision is consistent with those found in the U.S. model and many U.S. treaties.

The proposed treaty provides that the Slovenian taxes referred to in paragraph 1(b)(i) and (ii) and paragraph 2 of Article 2 (Taxes

Covered) are considered income taxes for purposes of the foregoing rules regarding the U.S. foreign tax credit. The proposed treaty excludes the Slovenian assets tax on banks and savings institutions, as described in paragraph 1(b)(iii) of Article 2, from treatment as income taxes.

The proposed treaty generally provides that Slovenia will allow residents of Slovenia, who derive income that, in accordance with the treaty, may be subject to tax in the United States, a deduction against Slovenian income tax for the U.S. incomes taxes paid. The deduction cannot exceed the portion of the income tax which has been computed before making the deduction which is attributable to the income which may be taxed in the United States. The proposed treaty provides that the taxes referred to in paragraphs 1(a) and 2 of Article 2 are to be treated as income taxes for this purpose.

Like the U.S. model and other U.S. treaties, the proposed treaty provides a special rule designed to provide relief from double taxation for U.S. citizens who are Slovenian residents. Under this rule, Slovenia will apply the foreign tax credit relief provisions to a U.S. citizen who is resident in Slovenia as if the person were not a U.S. citizen (*i.e.*, by taking into account only the amount of U.S. taxes that would be paid if he or she were not a U.S. citizen with respect to items of income that, under the proposed treaty, are either exempt from U.S. tax or are subject to a reduced rate of tax when derived from a Slovenian resident who is not a U.S. citizen). The United States then will credit the income tax actually paid to Slovenia (after application of the Slovenian credit). The proposed treaty recharacterizes the income that is subject to Slovenian taxation as Slovenian-source income for purposes of this computation, to the extent necessary to avoid double taxation under the computation. The result of this computation is that the ultimate U.S. tax liability of a U.S. citizen who is a Slovenian resident, with respect to an item of income, should not be less than the tax that would be paid if the individual were a Slovenian resident and not a U.S. citizen.

The proposed treaty also provides that where income is derived by a resident of one of the treaty countries that is exempt from tax by that country under any provision of the treaty, in determining the tax on the remaining income of the resident, that country may apply the rate of tax as if the exempted income had not been exempt. This provision is not included in the U.S. model, but is included in the OECD model.

Article 24. Non-Discrimination

The proposed treaty contains a comprehensive non-discrimination article relating to all taxes of every kind imposed at the national, state, or local level. It is similar to the non-discrimination article in the U.S. model and to provisions that have been included in other recent U.S. income tax treaties.

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

dents of the United States or Slovenia. The Technical Explanation states that whether or not two persons are both taxable on worldwide income is a significant circumstance for this purpose. Because the relevant circumstances include taxation on worldwide income, the proposed treaty does not obligate the United States to apply the same taxing regime to a national of Slovenia who is not resident in the United States and a U.S. national who is not resident in the United States. The proposed treaty states explicitly that U.S. citizens who are not residents of the United States but who are, nevertheless, subject to U.S. tax on their worldwide income are not in the same circumstances with respect to U.S. taxation as nationals of Slovenia who are not U.S. residents.

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

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

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

The proposed treaty provides that nothing in the non-discrimination article is to be construed as preventing either of the countries from imposing a branch-profits tax or a branch-level interest tax.

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

Article 25. Mutual Agreement Procedure

The proposed treaty contains the standard mutual agreement provision, with some variation, that authorizes the competent authorities of the two countries to consult together to attempt to alleviate individual cases of double taxation not in accordance with the proposed treaty and to resolve disputes and clarify issues that may arise under the treaty. The saving clause of the proposed treaty does not apply to this article, so that the application of this article might result in a waiver (otherwise mandated by the proposed treaty) of taxing jurisdiction by the country of citizenship or residence.

Under this article, a person who considers that the action of one or both of the countries will cause him or her to be subject to tax which is not in accordance with the proposed treaty may present his or her case (irrespective of the remedies under the domestic laws of the countries and the time limits prescribed in such laws for presenting refund claims) to the competent authority of the country of which he or she is a resident or national. The competent authority then makes a determination as to whether the objection appears justified. If the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, that competent authority endeavors to resolve the case by mutual agreement with the competent authority of the other country, with a view to the avoidance of taxation which is not in accordance with the proposed treaty. The provision authorizes a waiver of the statute of limitations of either country, provided that the case is presented to the competent authority within five years from the first notification of action resulting in taxation not in accordance with the treaty. The U.S. model does not specify any such time period; the OECD model specifies a three-year period. Assessment and collection procedures are suspended during the pendency of any mutual agreement proceeding.

The competent authorities of the countries must endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the proposed treaty. In particular, the competent authorities may agree to (1) the attribution of income, deductions, credits, or allowances of an enterprise of one treaty country to the enterprise's permanent establishment in the other country; (2) the allocation of income, deductions, credits, or allowances between persons; (3) the characterization of particular items of income; (4) the characterization of persons; (5) the application of source rules with respect to particular items of income; (6) a common meaning of a term and (7) increases in specific dollar thresholds in the proposed treaty to reflect economic or monetary developments. The competent authorities may also consult together for the elimination of double taxation regarding cases not provided for in the proposed treaty. This treatment is similar to the treatment under the U.S. model.

In addition, the proposed treaty provides that the competent authorities can agree that the conditions of the main purpose tests in Article 10 (Dividends), Article 11 (Interest), Article 12 (Royalties), or Article 21 (Other Income) have been met. The Technical Explanation states that, as is the case with all other matters, the agreement of the competent authorities does not have to relate to a particular case. As a result, the competent authorities could agree that all transactions of a particular type are entered into with a main purpose of taking advantage of the treaty and, therefore, deny treaty benefits to all taxpayers who had entered into such transactions. The main purpose tests do not appear in the U.S. model or in the OECD model.

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

Article 26. Exchange of Information and Administrative Assistance

This article provides for the exchange of information between the two countries. Notwithstanding the provisions of Article 2 (Taxes Covered), the proposed treaty's information exchange provisions apply to all taxes imposed in either country at the national level.

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

Any information exchanged under the proposed treaty will be treated as secret in the same manner as information obtained under the domestic laws of the country receiving the information. The exchanged information may be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment, collection, or administration, enforcement, or prosecution in respect of, or the determination of appeals in relation to, the taxes to which the proposed treaty would apply or the oversight thereof. Such persons or authorities may use the information for such purposes only.[6] The Technical Explanation states that persons involved in the administration of taxes include legislative bodies with oversight roles with respect to the administration of the tax laws, such as, for example, the tax-writing committees of Congress and the General Accounting Office. Information received by these bodies must be for use in the performance of their role in overseeing the administration of U.S. tax laws. Exchanged information

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

may be disclosed in public court proceedings or in judicial decisions.

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

The proposed treaty provides that upon an appropriate request for information, the requested country will obtain the information to which the request relates in the same manner and to the same extent as if the tax were its own tax (even if the requested country may not, at that time, need such information for purposes of its own tax). If specifically requested by the competent authority of a country, the competent authority of the other country will provide requested information in a form consistent with the purposes of the request to the same extent possible under its laws and administrative practices and procedures. Although this generally follows the U.S. model, the proposed treaty omits the provision in the U.S. model that requires information to be provided to the requesting country notwithstanding that such disclosure may be precluded by a bank secrecy law or similar legislation. According to the Technical Explanation, the United States has received assurances from the Slovenian Ministry of Finance concerning Slovenia's ability to exchange third-party information obtained from banks and other financial institutions.

Article 27. Diplomatic Agents and Consular Officers

The proposed treaty contains the rule found in the U.S. model and other U.S. tax treaties that its provisions do not affect the fiscal privileges of members of diplomatic agents or consular officers under the general rules of international law or the provisions of special agreements. Accordingly, the proposed treaty will not defeat the exemption from tax which a host country may grant to the salary of diplomatic officials of the other country. The saving clause does not apply to override any benefits of this article available to an individual who is neither a citizen of a treaty country nor has been admitted for permanent residence in that country. Thus, for example, U.S. diplomats who are considered Slovenian residents may be protected from Slovenian tax.

Article 28. Capital

Slovenia imposes an assets tax on banks and savings institutions (the "Assets Tax"), which is a covered tax under Article 2 (Taxes Covered). The proposed treaty specifies the circumstances under which a treaty country may impose a tax on capital owned by a resident of the other treaty country. Since the United States does not impose taxes on capital, the only capital taxes covered by the purposes treaty is the Assets Tax imposed by Slovenia. Thus, although the article is drafted in a reciprocal manner, its provisions are relevant only for the imposition of the Slovenian tax.

Under the proposed treaty, as a general rule, capital owned by a resident of a treaty country may be taxed only in that country. Slovenia, therefore, generally cannot tax a resident of the United States on capital owned by that resident. Two exceptions, however, are provided.

First, under the proposed treaty, capital represented by real property (as defined in Article 6) which is owned by a U.S. resident and situated in Slovenia may be taxed by Slovenia. Second, capital represented by personal property (movable property) forming part of the business property of a permanent establishment which a U.S. enterprise has in Slovenia or pertaining to a fixed base available to a U.S. resident for purposes of performing independent personal services may be taxed by Slovenia.

The proposed treaty provides that capital represented by ships, aircraft, or containers operated in international traffic, and by personal property (movable property) pertaining to the operation of such ships, aircraft, and containers is taxable only in the residence country of the enterprise that owns such capital.

Article 29. Entry Into Force

The proposed treaty provides that it is subject to ratification in accordance with the applicable procedures of each country, and that the instruments of ratification are to be exchanged as soon as possible. The proposed treaty will enter into force on the date the instruments of ratification are exchanged.

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

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

Article 30. Termination

The proposed treaty will continue in force until terminated by either country. Either country may terminate the proposed treaty by giving notice of termination to the other country through diplomatic channels. A termination is effective, with respect to taxes withheld at source for amounts paid or credited after the expiration of the six month period beginning on the date on which notice of termination was given. In the case of other taxes, a termination is effective for taxable periods beginning on or after the expiration of the six month period beginning on the date on which notice of termination was given.

IX. Text of the Resolution of Ratification

Resolved, (two-thirds of the Senators present concurring therein), That the Senate advise and consent to the ratification of the Convention between the United States of America and the Republic of Slovenia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, signed at Ljubljana on June 21, 1999 (Treaty Doc. 106–9), subject to the reservation of subsection (a), the understanding of subsection

(b), the declaration of subsection (c), and the proviso of subsection (d).

(a) RESERVATION.—The Senate's advice and consent is subject to the following reservation, which shall be included in the instrument of ratification, and shall be binding on the President:

(1) MAIN PURPOSE TESTS.—Paragraph 10 of Article 10 (Dividends), paragraph 10 of Article 11 (Interest), paragraph 7 of Article 12 (Royalties), paragraph 3 of Article 21 (Other Income), and subparagraph (g) of paragraph 3 of Article 25 (Mutual Agreement Procedure) of the Convention shall be stricken in their entirety.

(b) UNDERSTANDING.—The Senate's advice and consent is subject to the following understanding, which shall be included in the instrument of ratification, and shall be binding on the President:

(1) EXCHANGE OF INFORMATION.—The United States understands that, pursuant to Article 26 of the Convention, both the competent authority of the United States and the competent authority of the Republic of Slovenia have the authority to obtain and provide information held by financial institutions, nominees or persons acting in an agency or fiduciary capacity, or respecting interests in a person.

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

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

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

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

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