



# PAYROLL CURRENTLY

The Compliance Publication of the American Payroll Association

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## Update on Income Tax Treaties

The U.S. has income tax treaties with more than 60 countries. Income tax treaties may exempt or reduce the amount of withholding from wages earned by nonresident aliens in the U.S. if certain conditions are met (see *The Payroll Source*®, pp. 14-17 and 14-18 for additional discussion of income tax treaties). Since PAYROLL CURRENTLY last reported on the subject (see [Issue No. 11, Vol. 17](#)), a replacement treaty with Italy that was signed in 1999 and a protocol updating the income tax treaty with France have both entered into force.

### Treaty and protocols enter into force

**U.S.-Italy.** On December 16, 2009, a new income tax treaty between the U.S. and Italy entered into force following its approval by the Italian legislature. The treaty was signed by the two countries in 1999 and ratified by the U.S. Senate that year. It replaces an existing treaty and protocol in force since 1985. The treaty generally follows the format of the 1996 U.S. Model Tax Convention. (*Note:* In 2006, the Treasury Department issued a new version of the Model Income Tax Convention; see [PAYROLL CURRENTLY, Issue No. 16, Vol. 15](#).)

With respect to taxes withheld at source, the new treaty was effective for amounts paid or credited on or after February 1, 2010. For all other taxes, the new treaty covers taxable years beginning January 1, 2010.

**U.S.-France.** On December 23, 2009, a protocol to the income tax treaty with France entered into force, following ratification by the U.S. Senate. The protocol, signed on January 13, 2009, is the second update to the 1994 income tax treaty between the two countries. It provides for elimination of source-country taxation of certain dividends and royalty payments. Unlike mandatory arbitration provisions in U.S. income tax treaties with Belgium, Canada, and Germany that only allow arbitration concerning the application of certain treaty articles, the treaty with France provides for the arbitration of any case concerning the application of a treaty article unless the competent authorities of each country agree that the case is not suitable for arbitration. The treaty also seeks to prevent “treaty shopping” (the inappropriate use of a tax treaty by third-country residents), and modernizes rules for sharing taxpayer information between the two countries.

With respect to taxes withheld at source, the protocol was effective for amounts paid or credited on or after January 1, 2009. For all other taxes, the agreement generally took effect for taxable years beginning on or after January 1, 2010.

### Treaties and protocols awaiting Senate ratification

**U.S.-Malta.** An income tax treaty signed by the U.S. and Malta in 2008 was transmitted to the U.S. Senate for ratification on January 15, 2009. (*Note:* In 1997, the U.S. terminated a prior income tax treaty with Malta because at that time Malta did not generally permit sharing bank information with foreign tax authorities.) Under the new treaty, 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. The



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treaty also contains exemptions under which residents of one country performing personal services in the other country will not pay tax in the other country unless their contact with the other country exceeds specified minimums.

Pensions and other similar remuneration paid to a resident of one country will be taxed only by that country and only at the time and to the extent that a pension distribution is made. Students and business trainees who are residents of one treaty country and who visit the other treaty country (the host country) will generally be exempt from host-country taxation on certain types of payments received from sources in their home country for their maintenance, education, or training. The treaty includes a comprehensive limitation of benefits provision and provides for the exchange of information between the competent authorities of each country to facilitate tax administration.

**U.S.-New Zealand.** A protocol amending the 1982 income tax treaty between the U.S. and New Zealand was submitted to the U.S. Senate for ratification on June 16, 2009. It updates provisions governing residence in a treaty country, limitation of benefits, nondiscrimination, and exchange of information to make the treaty more compliant with current U.S. tax treaty policy. It clarifies that it covers U.S. income and excise taxes on private foundations imposed under the Internal Revenue Code, but not social security and unemployment taxes. It also removes a treaty article on individuals performing services in an independent capacity.

## **Newly signed treaties and protocols not yet transmitted to the Senate**

**U.S.-Chile.** On February 4, 2010, the U.S. and Chile signed the first income tax treaty between the two countries. It establishes rules to determine when an enterprise or an individual from one country is subject to tax on business activities in the other country. It coordinates the tax provisions of the U.S. and Chilean pension systems to facilitate the mobility of labor between the two countries. It has provisions exempting the income that a resident of the U.S. or Chile receives for performing personal services as an independent contractor or self-employed person in the other treaty country. The treaty also includes provisions exempting wages that a resident of the U.S. or Chile receives for performing labor or personal services as an employee in the other treaty country from the other country's income tax. It establishes mechanisms through which the U.S. and Chilean tax authorities may resolve tax disputes and relieve double taxation, and includes provisions to ensure that only residents of the two countries enjoy the benefits of the treaty.

**U.S.-Hungary.** On February 4, 2010, the U.S. and Hungary signed a new tax treaty to replace and update the existing agreement between the two countries that dates from 1979. In general, the treaty provides that the wages derived by a resident of one treaty country with respect to employment will be taxable only in that country unless the employment is performed in the other treaty country, in which case the wages may be taxed in that other country. It includes a provision to ensure that only residents of the U.S. and Hungary can benefit from the new treaty, and also features a new exemption from withholding tax on dividends paid to pension plans.



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**U.S.-Switzerland.** On September 23, 2009, the U.S. and Switzerland signed a protocol amending the existing tax treaty between the two countries. It includes new provisions designed to allow for more extensive exchange of information for income tax purposes. It also provides for mandatory arbitration when the competent authorities of each country are unable to reach complete agreement in a case and addresses issues concerning the cross-border taxation of individual retirement accounts.

## Information about tax treaties

- Detailed summaries of the individual tax treaties currently in force between the U.S. and other countries can be found in the APA's *Guide to Global Payroll Management* (see [www.americanpayroll.org/publication/](http://www.americanpayroll.org/publication/)).

- IRS Publication 515 (*Withholding of Tax on Nonresident Aliens and Foreign Entities*) contains general tax treaty information, as well as a table of tax treaties providing information about tax exemptions for nonresident aliens. Publications 901 (*U.S. Tax Treaties*) and 597 (*Information on the U.S.-Canada Income Tax Treaty*) contain more detailed explanations. Form 6166 is a letter of U.S. residency certification for purposes of claiming benefits under an income tax treaty. Rev. Proc. 2006-54 ([www.irs.gov/irb/2006-49\\_IRB/ar13.html](http://www.irs.gov/irb/2006-49_IRB/ar13.html)) outlines the procedures for obtaining U.S. competent authority assistance under an income tax treaty to which the U.S. is a party. (The IRS Deputy Commissioner (International), Large and Mid-Size Business Division, acts as the U.S. competent authority in administering the operating provisions of tax treaties.)

All of these materials, plus tax treaties and proposed treaty documents themselves, and the current 2006 Model Income Tax Convention and its technical explanation (a Model Income Tax Convention is used by the U.S. as a starting point in negotiating bilateral tax treaties with other countries) can be found on the IRS website at [www.irs.gov/businesses/international/article/0,,id=96739,00.html](http://www.irs.gov/businesses/international/article/0,,id=96739,00.html).