

DEPARTMENT OF THE TREASURY  
TECHNICAL EXPLANATION OF THE CONVENTION BETWEEN  
THE GOVERNMENT OF THE UNITED STATES OF AMERICA  
AND  
THE GOVERNMENT OF THE PEOPLE'S REPUBLIC OF BANGLADESH  
FOR THE AVOIDANCE OF DOUBLE TAXATION AND  
THE PREVENTION OF FISCAL EVASION  
WITH RESPECT TO TAXES ON INCOME  
SIGNED AT DHAKA, SEPTEMBER 26, 2004

This is a technical explanation of the Convention between the United States and Bangladesh signed at Dhaka on September 26, 2004 (the "Convention"). Negotiations with respect to the Protocol took into account the U.S. Department of the Treasury's current tax treaty policy and Treasury's Model Income Tax Convention published September 20, 1996 (the "U.S. Model").

Negotiations also took into account the Model Income Tax Convention on Income and on Capital, published by the Organization for Economic Cooperation and Development (the "OECD Model"), the United Nations Model Double Taxation Convention Between Developed and Developing Countries (the "UN Model"), and recent tax treaties concluded by both countries.

The Technical Explanation is an official guide to the Convention. It reflects the policies behind particular Convention provisions, as well as understandings reached with respect to the application and interpretation of the Convention. References in the Technical Explanation to "he" or "his" should be read to mean "he or she" and "his or her."

## **ARTICLE 1 (PERSONAL SCOPE)**

### *Paragraph 1*

Paragraph 1 of Article 1 provides that the Convention applies to residents of the United States or Bangladesh except where the terms of the Convention provide otherwise. Under Article 4 (Fiscal Domicile) a person is generally treated as a resident of a Contracting State if that person is, under the laws of that State, liable to tax therein by reason of his domicile or other similar criteria. If, however, a person is considered a resident of both Contracting States, a single state of residence is assigned under Article 4. This definition governs for all purposes of the Convention.

Certain provisions are applicable to persons who may not be residents of either Contracting State. For example, Article 20 (Government Service) may apply to an employee of a Contracting State who is resident in neither State. Paragraph 1 of Article 24 (Nondiscrimination) applies to nationals of the Contracting States. Under Article 26

(Exchange of Information and Administrative Assistance), information may be exchanged with respect to residents of third states.

### *Paragraph 2*

Paragraph 2 contains the traditional saving clause found in all U.S. treaties. Under subparagraph (a) of paragraph 2, Contracting States reserve their rights, except as provided in paragraph 3, to tax their residents and citizens as provided in their internal laws, notwithstanding any provisions of the Convention to the contrary. For example, if a resident of Bangladesh performs independent personal services in the United States and the individual is not present in the United States for 183 days in a 12-month period, and the income from the services is not attributable to a fixed base in the United States, Article 15 (Independent Personal Services) would normally prevent the United States from taxing the income. If, however, the resident of Bangladesh is also a citizen of the United States, the saving clause permits the United States to include the remuneration in the worldwide income of the individual and subject it to tax under the Internal Revenue Code of 1986 (“Code”) rules (i.e., without regard to Code section 894(a)). For special foreign tax credit rules applicable to the U.S. taxation of certain U.S. income of its citizens resident in Bangladesh, see paragraph 3 of Article 23 (Relief from Double Taxation).

For purposes of the saving clause, “residence” is determined under Article 4 (Fiscal Domicile). Thus, if an individual who is not a U.S. citizen is a resident of the United States under the Code, and is also a resident of Bangladesh under its law, and that individual has a permanent home available to him in Bangladesh and not in the United States, he would be treated as a resident of Bangladesh under Article 4 and for purposes of the saving clause. The United States would not be permitted to apply its statutory rules to that person if they are inconsistent with the treaty. Thus, an individual who is a U.S. resident under the Code but who is deemed to be a resident of Bangladesh under the tie-breaker rules of Article 4 (Fiscal Domicile) would be subject to U.S. tax only to the extent permitted by the Convention. However, the person would be treated as a U.S. resident for U.S. tax purposes other than determining the individual's U.S. tax liability. For example, in determining under Code section 957 whether a foreign corporation is a controlled foreign corporation, shares in that corporation held by the individual would be considered to be held by a U.S. resident. As a result, other U.S. citizens or residents might be deemed to be United States shareholders of a controlled foreign corporation subject to current inclusion of Subpart F income recognized by the corporation. See, Treas. Reg. section 301.7701(b)-7(a)(3).

Under subparagraph (b) of paragraph 2 each Contracting State also reserves its right to tax former citizens and long-term residents whose loss of citizenship or long-term residence had as one of its principal purposes the avoidance of tax. The subparagraph defines “long-term resident”, consistent with U.S. law, as an individual (other than a U.S. citizen) who is a lawful permanent resident of the United States in at least 8 of the prior 15 taxable years. An individual shall not be treated as a lawful permanent resident for any taxable year if such individual is treated as a resident of a foreign country under the

provisions of a tax treaty between the United States and the foreign country and the individual does not waive the benefits of such treaty applicable to residents of the foreign country.

In the United States, such a former citizen or long-term resident is taxable in accordance with the provisions of section 877 of the Code. Section 877 provides for special tax treatment of former U.S. citizens and long-term residents who gave up their citizenship or long-term resident status to avoid U.S. tax. Prior to its amendment by the American Jobs Creation Act of 2004 (AJCA), section 877 applied to individuals that relinquished U.S. citizenship or terminated long-term residency with a principal purpose (i.e., subjective intent) of tax avoidance. An individual was generally presumed to have a tax avoidance purpose if their net worth or average annual net income tax liability exceeded specified thresholds. AJCA replaced the subjective determination of tax avoidance as a principal purpose for relinquishment of citizenship or termination of residency with objective rules. Former citizens or long-term residents are now subject to U.S. tax for the 10-year period following loss of such status, unless they fall below certain net income and net worth thresholds or satisfy certain limited exceptions for dual citizens and minors who have had no substantial contact with the U.S.

Thus, section 877 now treats individuals who expatriate and meet the objective tests as having expatriated for tax avoidance purposes. Accordingly, the objective tests in section 877 represent the administrative means by which the United States determines whether a taxpayer has a tax avoidance purpose for purposes of the reservation of taxing rights contained in subparagraph (b) of paragraph 2.

### *Paragraph 3*

Some treaty provisions are intended to provide benefits to citizens and residents that do not exist under internal law. Paragraph 3 sets forth certain exceptions to the saving clause that preserve these benefits for citizens and residents of the Contracting States.

Subparagraph (a) lists certain provisions of the Convention that are applicable to all citizens and residents of a Contracting State, despite the general saving clause rule of paragraph 2:

(1) Paragraph 2 of Article 9 (Associated Enterprises) grants the right to a correlative adjustment with respect to income tax due on profits reallocated under Article 9.

(2) Paragraphs 2 and 5 of Article 19 (Pensions, Et Cetera) deal with social security benefits and child support payments, respectively. The inclusion of paragraph 2 in the exceptions to the saving clause means that the grant of exclusive taxing right of social security benefits to the paying country applies to deny, for example, to the United States the right to tax its citizens and residents on social security benefits paid by Bangladesh. The inclusion of paragraph 5, which exempts child-support-payments from taxation by the State of residence of the recipient, means that if a resident of Bangladesh pays child

support to a citizen or resident of the United States, the United States may not tax the recipient.

(3) Article 23 (Relief from Double Taxation) confirms the benefit of a credit to citizens and residents of one Contracting State for income taxes paid to the other, even if such a credit is not available under the domestic law of the first State.

(4) Article 24(Nondiscrimination) requires one Contracting State to grant national treatment to residents and citizens of the other Contracting State in certain circumstances. Excepting this Article from the saving clause requires, for example, that the United States give such benefits to a resident or citizen of Bangladesh even if that person is also a citizen of the United States.

(5) Article 25 (Mutual Agreement Procedure) may confer benefits on citizens and residents of the Contracting States. For example, the statute of limitations may be waived for refunds and the competent authorities are permitted to use a definition of a term that differs from the internal law definition. As with the foreign tax credit, these benefits are intended to be granted by a Contracting State to its citizens and residents.

Subparagraph (b) of paragraph 3 provides a different set of exceptions to the saving clause. The benefits referred to are all intended to be granted to temporary residents of a Contracting State (for example, in the case of the United States, holders of non-immigrant visas), but not to citizens or to persons who have acquired permanent residence in that State. If beneficiaries of these provisions travel from one of the Contracting States to the other, and remain in the other long enough to become residents under its internal law, but do not acquire permanent residence status (i.e., in the U.S. context, they do not become “green card” holders) and are not citizens of that State, the host State will continue to grant these benefits even if they conflict with their statutory rules. The benefits preserved by this paragraph are the host country exemptions for the following items of income: government service salaries and pensions under Article 20 (Government Service); certain income of visiting teachers, students and trainees under Article 21 (Teachers, Students and Trainees); and the income of diplomatic agents and consular officers under Article 27 (Effect of Convention on Diplomatic Agents and Consular Officers, Domestic Laws and Other Treaties).

The provisions dealing with the relationship between the Convention and other laws and treaties of the Contracting States, normally dealt with in Article 1 of U.S. treaties are found in Article 27 (Effect of Convention on Diplomatic Agents and Consular Officers, Domestic Laws and Other Treaties) of the Convention.

## **ARTICLE 2 (TAXES COVERED)**

This Article specifies the U.S. taxes and the taxes of Bangladesh to which the convention applies. With one exception, the taxes specified in Article 2 are the covered taxes for all purposes of the Convention. A broader coverage applies, however, for purposes of Article 24 (Nondiscrimination). Article 24 applies with respect to all taxes, including those imposed by state and local governments.

### *Paragraph 1*

Paragraph 1 is based on the OECD Model and provides that the Convention applies to income taxes imposed on behalf of either Contracting State; this covers taxes on total income or any part of income and includes tax on gains derived from property. The Convention does not apply to payroll taxes. Nor does it apply to property taxes, except with respect to Article 24 (NonDiscrimination).

### *Paragraph 2*

Subparagraph 2(a) provides that the United States covered taxes are the Federal income taxes imposed by the Code. Social security taxes (Code sections 1401, 3101, 3111 and 3301) are not covered taxes. Although, unlike the U.S. Model, the Convention does not specify the exclusion of social security taxes, the Commentary to Article 2 of the OECD Model state that social security taxes are not income taxes for these purposes. Except with respect to Article 24 (Nondiscrimination), state and local taxes in the United States are not covered by the Convention.

Subparagraph 1(b) specifies the existing taxes of Bangladesh that are covered by the Convention. This is the income tax, and it includes any surcharges that are calculated by reference to the income taxes.

### *Paragraph 3*

Under paragraph 3, the Convention will apply to any taxes that are identical, or substantially similar, to those enumerated in paragraph 2, and which are imposed in addition to, or in place of, the existing taxes after the date of signature of the Convention. The paragraph also provides that the competent authorities of the Contracting States will notify each other of changes in their taxation laws or of other laws that significantly affect their obligations under the Convention. The use of the term “significantly” means that changes must be reported that are of significance to the operation of the Convention. Other laws that may affect a Contracting State's obligations under the Convention may include, for example, laws affecting bank secrecy.

## **ARTICLE 3 (GENERAL DEFINITIONS)**

### *Paragraph 1*

Paragraph 1 defines a number of basic terms used in the Convention. Certain others are defined in other articles of the Convention. For example, the term “resident of a Contracting State” is defined in Article 4 (Fiscal Domicile). The term “permanent establishment” is defined in Article 5 (Permanent Establishment). The terms “dividends,” “interest,” and “royalties” are defined in Articles 10, 11 and 12, respectively. The introduction to paragraph 1 makes clear that the definitions in this paragraph apply for all purposes of the Convention, unless the context requires otherwise. This latter condition

allows flexibility in the interpretation of the treaty in order to avoid unintended results. Terms that are not defined in the Convention are dealt with in paragraph 2.

Subparagraph 1(a) defines the term “person” to include an individual, a partnership, a company, an estate, a trust, and any other body of persons. The definition is significant for a variety of reasons. For example, under Article 4 (Fiscal Domicile), only a “person” can be a “resident” and therefore eligible for most benefits under the treaty. Also, all “persons” are eligible to claim relief under Article 25 (Mutual Agreement Procedure).

The term “company” is defined in subparagraph 1(b) as a body corporate or an entity treated as a body corporate for tax purposes in the state where it is organized or has its place of effective management.

The terms “enterprise of a Contracting State” and “enterprise of the other Contracting State” are defined in subparagraph 1(c) as an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State. The term “enterprise” is not defined in the Convention. The OECD Model defines the term as applying to the carrying on of any business. This meaning of the term applies for purposes of the Convention as well.

Although subparagraph 1(c) does not include the U.S. Model's explicit reference to fiscally transparent enterprises, it is understood that the terms “enterprise of a Contracting State” and “enterprise of the other Contracting State” encompass an enterprise conducted through an entity (such as a partnership) that is treated as fiscally transparent in the Contracting State where the entity's owner is resident. In accordance with Article 4 (Fiscal Domicile), entities that are fiscally transparent in the country in which their owners are resident are not considered to be residents of a Contracting State (although income derived by such entities may be taxed as the income of a resident, if taxed in the hands of resident partners or other owners). This treatment ensures that an enterprise conducted by such an entity will be treated as carried on by a resident of a Contracting State to the extent its partners or other owners are residents. This approach is consistent with the Code, which under section 875 attributes a trade or business conducted by a partnership to its partners and a trade or business conducted by an estate or trust to its beneficiaries.

An enterprise of a Contracting State need not be carried on in that State. It may be carried on in the other Contracting State or a third state (e.g., a U.S. corporation doing all of its business in Bangladesh would still be a U.S. enterprise).

Subparagraph 1(d) defines the term “international traffic.” The term means any transport by a ship or aircraft except when the vessel is operated solely between places within a Contracting State. This definition is applicable principally in the context of Article 8 (Shipping and Air Transport). The definition in the OECD Model refers to the operator of the ship, or aircraft having its place of effective management in a Contracting State (i.e., being a resident of that State). The U.S. Model does not include this limitation.

The broader definition combines with paragraphs 2 and 4 of Article 8 to exempt from tax by the source State income from the rental of aircraft or containers that is earned both by lessors that are operators of aircraft and by those lessors that are not (e.g., a bank or a container leasing company).

The exclusion from international traffic of transport solely between places within a Contracting State means, for example, that carriage of goods or passengers solely between New York and Chicago would not be treated as international traffic, whether carried by a U.S. or a Bangladesh carrier. If, however, goods or passengers are carried by a carrier resident in Bangladesh from a non-U.S. port to, for example, New York, and some of the goods or passengers continue on to Chicago, the entire transport would be international traffic. This would be true if the international carrier transferred the goods at the U.S. port of entry from an aircraft to a land vehicle, or even if the overland portion of the trip in the United States was handled by an independent carrier under contract with the original Bangladesh carrier, so long as both parts of the trip were reflected in original bills of lading. For this reason, the Convention refers, in the definition of “international traffic,” to “such transport” being solely between places in a Contracting State, while the OECD Model refers to the ship or aircraft being operated solely between such places. The language in the Convention is intended to make clear that, as in the above example, even if the goods are carried on a different aircraft for the internal portion of the international voyage than is used for the overseas portion of the trip the definition applies to that internal portion as well as the external portion.

Finally, a “cruise to nowhere,” i.e., a cruise beginning and ending in a port in the same Contracting State with no stops in a foreign port, would not constitute international traffic.

Subparagraphs 1(e)(i) and (ii) define the term “competent authority” for the United States and Bangladesh, respectively. The U.S. competent authority is the Secretary of the Treasury or his delegate. The Secretary of the Treasury has delegated the competent authority function to the Commissioner of Internal Revenue, who in turn has delegated the authority to the Director, International (LMSB) and, with respect to interpretative issues, the Director, International (LMSB) with the concurrence of the Associate Chief Counsel (International) of the Internal Revenue Service.

The term “United States” is defined in subparagraph 1(f) to mean the United States of America, including the states, the District of Columbia and the territorial sea of the United States. The term does not include Puerto Rico, the Virgin Islands, Guam or any other U.S. possession or territory. This Convention explicitly includes certain areas under the sea within the definition of the United States. For certain purposes, the definition is extended to include the sea bed and subsoil of undersea areas adjacent to the territorial sea of the United States. This extension applies to the extent that the United States exercises sovereignty in accordance with international law for the purpose of natural resource exploration and exploitation of such areas. This extension of the definition applies, however, only if the person, property or activity to which the Convention is being applied is connected with such natural resource exploration or

exploitation. Thus, it would not include any activity involving the sea floor of an area over which the United States exercised sovereignty for natural resource purposes if that activity was unrelated to the exploration and exploitation of natural resources.

The term “Bangladesh” is defined in subparagraph 1(g) to mean the People's Republic of Bangladesh. The term is defined to include the territorial sea, sea bed and subsoil adjacent to the territorial sea over which Bangladesh exercises its sovereign rights in accordance with international law.

The term “national” as it relates to Bangladesh and to the United States, is defined in subparagraphs 1(h)(i) and (ii), respectively. This term is relevant for purposes of Articles 20 (Government Service) and 24 (Nondiscrimination). A national of one of the Contracting States is (1) an individual who is a citizen or national of that State, and (2) any legal person, partnership or association deriving its status, as such, from the law in force in the State where it is established.

### *Paragraph 2*

Paragraph 2 provides that in the application of the Convention, any term used but not defined in the Convention will have the meaning that it has under the law of the Contracting State whose tax is being applied, unless the context requires otherwise. If the term is defined under both the tax and nontax laws of a Contracting State, the definition in the tax law will take precedence over the definition in the non-tax laws.

Finally, there also may be cases where the tax laws of a State contain multiple definitions of the same term. In such a case, the definition used for purposes of the particular provision at issue, if any, should be used.

If the meaning of a term cannot be readily determined under the law of a Contracting State, or if there is a conflict in meaning under the laws of the two States that creates difficulties in the application of the Convention, the competent authorities, as indicated in paragraph 3(e) of Article 25 (Mutual Agreement Procedure), may establish a common meaning in order to prevent double taxation or to further any other purpose of the Convention. This common meaning need not conform to the meaning of the term under the laws of either Contracting State.

The reference in paragraph 2 to the internal law of a Contracting State means the law in effect at the time the treaty is being applied, not the law as in effect at the time the treaty was signed. This use of “ambulatory definitions” has been clarified in this paragraph by the use of the phrase “at that time.”

The use of “ambulatory” definitions, however, may lead to results that are at variance with the intentions of the negotiators and of the Contracting States when the treaty was negotiated and ratified. The reference in both paragraphs 1 and 2 to the “context otherwise requiring” a definition different from the treaty definition, in paragraph 1, or from the internal law definition of the Contracting State whose tax is



being imposed, under paragraph 2, refers to a circumstance where the result intended by the Contracting States is different from the result that would obtain under either the paragraph 1 definition or the statutory definition. Thus, flexibility in defining terms is necessary and permitted.

#### **ARTICLE 4 (FISCAL DOMICILE)**

This Article sets forth rules for determining whether a person is a resident of a Contracting State for purposes of the Convention. As a general matter only residents of the Contracting States may claim the benefits of the Convention. The treaty definition of residence is to be used only for purposes of the Convention. The fact that a person is determined to be a resident of a Contracting State under Article 4 does not necessarily entitle that person to the benefits of the Convention. In addition to being a resident, a person also must qualify for benefits under Article 17 (Limitation on Benefits) in order to receive benefits conferred on residents of a Contracting State.

The determination of residence for treaty purposes looks first to a person's liability to tax as a resident under the respective taxation laws of the Contracting States. As a general matter, a person who, under those laws, is a resident of one Contracting State and not of the other need look no further. That person is a resident for purposes of the Convention of the State in which he is resident under internal law. If, however, a person is resident in both Contracting States under their respective taxation laws, the Article provides tie-breaker rules pursuant to which a person is assigned, where possible, a single State of residence for purposes of the Convention.

##### *Paragraph 1*

The term “resident of a Contracting State” is defined in paragraph 1. In general, this definition incorporates the definitions of residence in U.S. law and that of Bangladesh by referring to a resident as a person who, under the laws of a Contracting State, is subject to tax there by reason of his domicile, residence, citizenship, place of management, place of incorporation or any other similar criterion. Thus, residents of the United States include aliens who are considered U.S. residents under Code section 7701(b).

Paragraph 1 also addresses special cases that may arise in the context of Article 4.

The paragraph makes explicit the generally understood practice of including within the term “resident of a Contracting State” the Government of that state as well as any political subdivisions or local authorities of that State.

Certain entities that are nominally subject to tax but that in practice rarely pay tax also would generally be treated as residents and therefore accorded treaty benefits. For example, a U.S. Regulated Investment Company (RIC), U.S. Real Estate Investment Trust (REIT) and U.S. Real Estate Mortgage Investment Conduit (REMIC) are all residents of the United States for purposes of the treaty. Although the income earned by

these entities normally is not subject to U.S. tax in the hands of the entity, they are taxable to the extent that they do not currently distribute their profits, and therefore may be regarded as “liable to tax.” They also must satisfy a number of requirements under the Code in order to be entitled to special tax treatment.

Subparagraph (a) provides that a person who is liable to tax in a Contracting State only in respect of income from sources within that State will not be treated as a resident of that Contracting State for purposes of the Convention. Thus, a consular official of Bangladesh who is posted in the United States, who may be subject to U.S. tax on U.S. source investment income, but is not taxable in the United States on non-U.S. source income, would not be considered a resident of the United States for purposes of the Convention. (See Code section 7701(b)(5)(B)). Similarly, although not explicitly stated in the Convention, an enterprise of Bangladesh with a permanent establishment in the United States is not, by virtue of that permanent establishment, a resident of the United States. The enterprise generally is subject to U.S. tax only with respect to its income that is attributable to the U.S. permanent establishment, not with respect to its worldwide income, as is a U.S. resident.

Subparagraph (b) addresses special problems presented by partnerships, trusts or estates (i.e., fiscally transparent entities). This subparagraph applies to any resident of a Contracting State who is entitled to income derived through an entity that is treated as an entity that is a partnership, trust, or estate under the laws of either Contracting State. Entities falling under this description in the United States would include partnerships, common investment trusts under section 584 and grantor trusts. This paragraph also applies to U.S. limited liability companies (“LLCs”) that are treated as partnerships for U.S. tax purposes.

Subparagraph (b) provides that an item of income derived by such a fiscally transparent entity is considered to be derived by a resident of a Contracting State to the extent that the resident is treated under the taxation laws of the State where he is resident as deriving the item of income. For example, if a corporation resident in Bangladesh distributes a dividend to an entity that is treated as fiscally transparent for U.S. tax purposes, the dividend will be considered derived by a resident of the United States only to the extent that the taxation laws of the United States treat one or more U.S. residents (whose status as U.S. residents is determined, for this purpose, under U.S. tax laws) as deriving the dividend income for U.S. tax purposes. In the case of a partnership, the persons who are, under U.S. tax laws, treated as partners of the entity would normally be the persons whom the U.S. tax laws would treat as deriving the dividend income through the partnership. Thus, it also follows that persons whom the U.S. treats as partners but who are not U.S. residents for U.S. tax purposes may not claim a benefit for the dividend paid to the entity under the Convention. Although these partners are treated as deriving the income for U.S. tax purposes, they are not residents of the United States for purposes of the treaty. If, however, they are treated as residents of a third country under the provisions of an income tax convention which that country has with Bangladesh, they may be entitled to claim a benefit under that convention. In contrast, if an entity is organized under U.S. laws and is classified as a corporation for U.S. tax purposes,

dividends paid by a corporation resident in Bangladesh to the U.S. entity will be considered derived by a resident of the United States since the U.S. corporation is treated under U.S. taxation laws as a resident of the United States and as deriving the income.

These results would obtain even if the entity were viewed differently under the tax laws of Bangladesh (e.g., as not fiscally transparent in the first example above where the entity is treated as a partnership for U.S. tax purposes or as fiscally transparent in the second example where the entity is viewed as not fiscally transparent for U.S. tax purposes). These results also follow regardless of where the entity is organized, i.e., in the United States, Bangladesh, or in a third country. For example, income from sources in Bangladesh received by an entity organized under the laws of Bangladesh, which is treated for U.S. tax purposes as a corporation and is owned by a U.S. shareholder who is a U.S. resident for U.S. tax purposes, is not considered derived by the shareholder of that corporation even if, under the tax laws of Bangladesh, the entity is treated as fiscally transparent. Rather, for purposes of the treaty, the income is treated as derived by an entity resident in Bangladesh. These results also follow regardless of whether the entity is disregarded as a separate entity under the laws of one jurisdiction but not the other, such as a single owner entity that is viewed as a branch for U.S. tax purposes and as a corporation for tax purposes of in Bangladesh.

Where income is derived through an entity organized in a third state that has owners resident in one of the Contracting States, the characterization of the entity in that third state is irrelevant for purposes of determining whether the resident is entitled to treaty benefits with respect to income derived by the entity.

These principles also apply to trusts to the extent that they are fiscally transparent in either Contracting State. For example, if X, a resident of Bangladesh, creates a revocable trust and names persons resident in a third country as the beneficiaries of the trust, X would be treated as the beneficial owner of income derived from the United States under U.S. domestic law. If Bangladesh has no rules comparable to those in sections 671 through 679, it is possible that under Bangladesh's law neither X nor the trust would be taxed on the income derived from the United States. In these cases subparagraph (d) provides that the U.S. source income is regarded as being derived by a resident of Bangladesh only to the extent that the laws of Bangladesh treat residents of Bangladesh as deriving the income for tax purposes.

The taxation laws of a Contracting State may treat an item of income as income of a resident of that State even if the resident is not subject to tax on that particular item of income. For example, if a Contracting State has a participation exemption for certain foreign-source dividends and capital gains, such income or gains would be regarded as income or gain of a resident of that State who otherwise derived the income or gain, despite the fact that the resident could be exempt from tax in that State on the income or gain.

Subparagraph (c) provides that certain tax-exempt entities such as pension funds and charitable organizations will be regarded as residents regardless of whether they are

generally liable for income tax in the State where they are established. An entity will be described in this subparagraph if it is generally exempt from tax by reason of the fact that it is organized and operated exclusively to perform a charitable or similar purpose or to provide pension or similar benefits to employees. The reference to “similar benefits” is intended to encompass employee benefits such as health and disability benefits.

The inclusion of this provision is intended to clarify the generally accepted practice of treating an entity that would be liable for tax as a resident under the internal law of a state but for a specific exemption from tax (either complete or partial) as a resident of that state for purposes of paragraph 1. The reference to a general exemption is intended to reflect the fact that under U.S. law, certain organizations that generally are considered to be tax-exempt entities may be subject to certain excise taxes or to income tax on their unrelated business income. Thus, a U.S. pension trust, or an exempt section 501(c) organization (such as a U.S. charity) that is generally exempt from tax under U.S. law is considered a resident of the United States for all purposes of the treaty.

#### *Paragraph 2*

If, under the laws of the two Contracting States, and, thus, under paragraph 1, an individual is deemed to be a resident of both Contracting States, a series of tie-breaker rules are provided in paragraph 2 to determine a single State of residence for that individual. These tests are to be applied in the order in which they are stated. The first test is based on where the individual has a permanent home. If that test is inconclusive because the individual has a permanent home available to him in both States, or in neither, he will be considered to be a resident of the Contracting State where his personal and economic relations are closest (i.e., the location of his “center of vital interests”). If that test is also inconclusive, he will be treated as a resident of the Contracting State where he maintains an habitual abode. If he has an habitual abode in both States or in neither of them, he will be treated as a resident of the Contracting State of which he is a national. If he is a national of both States or of neither, the matter will be considered by the competent authorities, who will assign a single State of residence.

#### *Paragraph 3*

Paragraph 3 provides a tie-breaker rule to settle dual-residence issues for companies. A company is treated as resident in the United States if it is created or organized in or under the laws of the United States or a political subdivision. Under the laws of Bangladesh, a company is treated as a resident of Bangladesh if it is either incorporated there or managed and controlled there. Dual residence, therefore, can arise in the case of a U.S. company that is managed and controlled in Bangladesh. Under paragraph 3, the residence of such a company will be in the Contracting State under the laws of which it is created or organized (i.e., the United States, in the example).

*Paragraph 4*

Dual residents other than individuals or companies (such as trusts or estates) are addressed by paragraph 4. If such a person is, under the rules of paragraph 1, resident in both Contracting States, the competent authorities shall seek to determine a single State of residence for that person for purposes of the Convention.

**ARTICLE 5 (PERMANENT ESTABLISHMENT)**

This Article defines the term “permanent establishment,” a term that is significant for several articles of the Convention. The existence of a permanent establishment in a Contracting State is necessary under Article 7 (Business Profits) for the taxation by that State of the business profits of a resident of the other Contracting State. Since the term “fixed base” in Article 15 (Independent Personal Services) is understood by reference to the definition of “permanent establishment,” this Article is also relevant for purposes of Article 15. Articles 10, 11 and 12 (dealing with dividends, interest, and royalties, respectively), provide for reduced rates of tax at source on payments of these items of income to a resident of the other State only when the income is not attributable to a permanent establishment or fixed base that the recipient has in the source State. The concept is also relevant in determining which Contracting State may tax certain gains under Article 13 (Capital Gains) and certain “other income” under Article 22 (Other Income).

*Paragraph 1*

The basic definition of the term “permanent establishment” is contained in paragraph 1. As used in the Convention, the term means a fixed place of business through which the business of an enterprise is wholly or partly carried on. As indicated in the OECD Commentary to Article 5, a general principle to be observed in determining whether a permanent establishment exists is that the place of business must be “fixed” in the sense that a particular building or physical location is used by the enterprise for the conduct of its business, and that it must be foreseeable that the enterprise's use of this building or other physical location will be more than temporary.

*Paragraph 2*

Paragraph 2 lists a number of types of fixed places of business that constitute a permanent establishment. This list is illustrative and non-exclusive. According to paragraph 2, the term permanent establishment includes a place of management, a branch, an office, a factory, a workshop, a store or other sales outlet, a warehouse (in relation to a person providing storage facilities for others) and a mine, oil or gas well, quarry or other place of extraction of natural resources.

### *Paragraph 3*

This paragraph provides rules to determine whether a building site or a construction, assembly or installation project, or a drilling rig used for the exploration or development of natural resources constitutes a permanent establishment for the contractor, driller, etc. Such an activity does not create a permanent establishment under paragraph 4(e) unless the site, project, etc. lasts or continues for more 183 days. It is only necessary to refer to “exploration” and not “exploitation” in this context because exploitation activities are defined to constitute a permanent establishment under subparagraph (h) of paragraph 2. Thus, a drilling rig does not constitute a permanent establishment if a well is drilled in only three months, but if production begins the next month, the well becomes a permanent establishment as of that date under subparagraph 2(h), even though the 183-day threshold of paragraph 3 has not been met.

The 183-day test applies separately to each site or project. The 183-day period begins when work (including preparatory work carried on by the enterprise) physically begins in a Contracting State. A series of contracts or projects by a contractor that are interdependent both commercially and geographically are to be treated as a single project for purposes of applying the 183-day threshold test. For example, the construction of a housing development would be considered as a single project even if each house were constructed for a different purchaser. Several drilling rigs operated by a drilling contractor in the same sector of the continental shelf also normally would be treated as a single project.

If the 183-day threshold is exceeded, the site or project constitutes a permanent establishment from the first day of activity. In applying this paragraph, time spent by a subcontractor on a building site is counted as time spent by the general contractor at the site for purposes of determining whether the general contractor has a permanent establishment. However, for the sub-contractor itself to be treated as having a permanent establishment, the sub-contractor's activities at the site must last for more than 183 days. If a sub-contractor is on a site intermittently time is measured from the first day the subcontractor is on the site until the last day (i.e., intervening days that the sub-contractor is not on the site are counted) for purposes of applying the 183-day rule.

These interpretations of the Article are based on the Commentary to paragraph 3 of Article 5 of the OECD Model, which contains language almost identical to that in the Convention (except for the length of the time threshold and the absence in the OECD Model of a rule for drilling rigs). These interpretations are consistent with the generally accepted international interpretation of the language in paragraph 3 of Article 5 of the Convention.

### *Paragraph 4*

This paragraph contains exceptions to the general rule of paragraph 1, listing a number of activities that may be carried on through a fixed place of business, but which nevertheless do not create a permanent establishment. The use of facilities solely to store

or display merchandise belonging to an enterprise does not constitute a permanent establishment of that enterprise. The maintenance of a stock of goods belonging to an enterprise solely for the purpose of storage or display, or solely for the purpose of processing by another enterprise does not give rise to a permanent establishment of the first-mentioned enterprise. The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise, or for other activities that have a preparatory or auxiliary character for the enterprise, such as advertising, or the supply of information do not constitute a permanent establishment of the enterprise. Thus, for example, an employee of a U.S. manufacturer gathering information as part of a market research project would not constitute a permanent establishment of the manufacturer, even if the activity takes place through a fixed place of business. Similarly, as explained in paragraph 22 of the OECD Commentary to Article 5, an employee of a news organization engaged merely in gathering information would not constitute a permanent establishment of the news organization.

Subparagraph 4(f) provides that a combination of the activities described in the other subparagraphs of paragraph 4 will not give rise to a permanent establishment if the combination results in an overall activity that is of a preparatory or auxiliary character. This combination rule, derived from the OECD Model, differs from that in the U.S. Model. In the U.S. Model, any combination of otherwise excepted activities is deemed not to give rise to a permanent establishment, without the additional requirement that the combination, as distinct from each constituent activity, be preparatory or auxiliary. It is assumed that if preparatory or auxiliary activities are combined, the combination generally will also be of a character that is preparatory or auxiliary. If, however, this is not the case, a permanent establishment may result from a combination of such activities.

#### *Paragraph 5*

Unlike the U.S. and OECD Models, subparagraphs (a) and (b) of paragraph 4 do not include the use of facilities or the maintenance of a stock of goods solely for the purpose of delivery within the categories of preparatory and auxiliary functions that do not constitute a permanent establishment. Paragraph 5, however, adds that the term “permanent establishment” shall be deemed not to include the use of facilities or the maintenance of a stock of goods or merchandise for the purpose of occasional delivery of such goods or merchandise. A permanent establishment does exist if deliveries are made on a regular basis from a warehouse or other storage facility.

#### *Paragraph 6*

Paragraphs 6 and 7 specify when activities carried on by an agent on behalf of an enterprise create a permanent establishment of that enterprise. Paragraph 6 sets forth two sets of conditions under which a dependent agent of an enterprise is deemed to constitute a permanent establishment of the enterprise. Under subparagraph 6(a), a dependent agent of an enterprise of a Contracting State will give rise to a permanent establishment of the enterprise in the other Contracting State, if the agent has and habitually exercises in that

other State a general authority to conclude contracts on behalf of that enterprise, and his activities are not limited to those activities specified in paragraphs 4 and 5 which would not constitute a permanent establishment if carried on by the enterprise through a fixed place of business. Under subparagraph 6(b), even if the agent has no authority to conclude contracts, he will give rise to a permanent establishment for the enterprise if he habitually maintains a stock of goods or merchandise in the other State on behalf of the enterprise and regularly makes deliveries from that stock, and there have been some additional activities carried on in that other State on behalf of the enterprise which have contributed to the sale. It is not necessary that these sales activities be carried out by the agent. They may be carried out by the enterprise itself or by another agent.

The contracts referred to in paragraph 6 are those relating to the essential business operations of the enterprise, rather than ancillary activities. For example, if the agent has no authority to conclude contracts on behalf of the enterprise with its customers for, say, the sale of the goods produced by the enterprise, but it can enter into service contracts on behalf of the enterprise for the enterprise's business equipment used in the agent's office, this contracting authority would not fall within the scope of the paragraph, even if exercised regularly.

#### *Paragraph 7*

Under paragraph 7, an enterprise is not deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through an independent agent, including a broker or general commission agent, if the agent is acting in the ordinary course of his business as an independent agent. Thus, there are two conditions that must be satisfied: the agent must be both legally and economically independent of the enterprise, and the agent must be acting in the ordinary course of its business in carrying out activities on behalf of the enterprise.

Whether an agent is independent of an enterprise is a factual determination. Among the questions to be considered are the extent to which the agent operates on the basis of instructions from the enterprise. An agent that is subject to detailed instructions regarding the conduct of its operations or comprehensive control by the enterprise is not legally independent.

In determining whether the agent is economically independent, a relevant factor is the extent to which the agent bears business risk. Business risk refers primarily to risk of loss. An independent agent typically bears risk of loss from its own activities. In the absence of other factors that would establish dependence, an agent that shares business risk with the enterprise, or has its own business risk, is economically independent because its business activities are not integrated with those of the principal. Conversely, an agent that bears little or no risk from those activities it performs is not economically independent and therefore is not described in paragraph 6.

Another relevant factor in determining whether an agent is economically independent is whether the agent has an exclusive or nearly exclusive relationship with



the principal. Such a relationship may indicate that the principal has economic control over the agent. A number of principals acting in concert also may have economic control over an agent. The limited scope of the agent's activities and the agent's dependence on a single source of income may indicate that the agent lacks economic independence. It should be borne in mind, however, that exclusivity is not in itself a conclusive test: An agent may be economically independent notwithstanding an exclusive relationship with the principal if it has the capacity to diversify and acquire other clients without substantial modifications to its current business and without substantial harm to its business profits. Thus, exclusivity should be viewed merely as a pointer to further investigation of the relationship between the principal and the agent. Each case must be addressed on the basis of its own facts and circumstances.

#### *Paragraph 8*

This paragraph clarifies that a company that is a resident of a Contracting State is not deemed to have a permanent establishment in the other Contracting State merely because it controls, or is controlled by, a company that is a resident of that other Contracting State, or that carries on business in that other Contracting State. The determination whether a permanent establishment exists is made solely on the basis of the factors described in paragraphs 1 through 7 of the Article. Whether a company is a permanent establishment of a related company, therefore, is based solely on those factors and not on the ownership or control relationship between the companies.

### **ARTICLE 6 (INCOME FROM IMMOVABLE PROPERTY)**

The term “immovable property” is used throughout the Article. It is intended to have the same meaning as the term “real property.”

#### *Paragraph 1*

The first paragraph of Article 6 states the general rule that income of a resident of a Contracting State derived from real property situated in the other Contracting State may be taxed in the Contracting State in which the property is situated. The paragraph specifies that income from real property includes income from agriculture and forestry. Income from agriculture and forestry are dealt with in Article 6 rather than in Article 7 (Business Profits). However, both the United States and Bangladesh give taxpayers the option to be taxed on such income on a net basis. Accordingly, taxpayers generally should be able to obtain the same tax treatment in the situs country regardless of whether the income is treated as business profits or real property income.

This Article does not grant an exclusive taxing right to the situs State. The situs State is merely given the primary right to tax. The Article does not impose any limitation in terms of rate or form of tax on the situs State.

### *Paragraph 2*

The term “immovable property” is defined in paragraph 2 by reference to the internal law definition in the situs State. In the case of the United States, the term has the meaning given to it by Reg. section 1.897-1(b). In addition to the statutory definitions in the two Contracting States, the paragraph specifies certain additional classes of property that, regardless of internal law definitions, are to be included within the meaning of the term for purposes of the Convention. This expanded definition conforms to that in the OECD Model. The definition of “immovable property” for purposes of Article 6 is more limited than the expansive definition of “immovable property” in paragraph 1 of Article 13 (Capital Gains). The Article 13 term includes not only immovable property as defined in Article 6 but certain other interests in real property.

### *Paragraph 3*

Paragraph 3 makes clear that all forms of income derived from the exploitation of real property are taxable in the Contracting State in which the property is situated. In the case of a net lease of real property, if a net election has not been made, the gross rental payment (before deductible expenses incurred by the lessee) is treated as income from the property. Income from the disposition of an interest in real property, however, is not considered “derived” from real property and is not dealt with in this Article. The taxation of that income is addressed in Article 13 (Capital Gains). Also, the interest paid on a mortgage on real property and distributions by a U.S. Real Estate Investment Trust are not dealt with in Article 6. Such payments fall under Articles 10 (Dividends), 11 (Interest) or 13 (Capital Gains). Finally, dividends paid by a United States Real Property Holding Corporation are not considered to be income from the exploitation of real property. Such payments would fall under Article 10 (Dividends) or 13 (Capital Gains).

Paragraph 3 clarifies that the income referred to in paragraph 1 also means income from any use of real property, including, but not limited to, income from direct use by the owner (in which case income may be imputed to the owner for tax purposes) and rental income from the letting of real property.

### *Paragraph 4*

This paragraph specifies that the basic rule of paragraph 1 (as elaborated in paragraph 3) applies to income from real property of an enterprise and to income from real property used for the performance of independent personal services. This clarifies that the situs country may tax the real property income (including rental income) of a resident of the other Contracting State in the absence of attribution to a permanent establishment or fixed base in the situs State. This provision represents an exception to the general rule under Articles 7 (Business Profits) and 15 (Independent Personal Services) that income must be attributable to a permanent establishment or fixed base, respectively, in order to be taxable in the situs state.

## **ARTICLE 7 (BUSINESS PROFITS)**

This Article provides rules for the taxation by a Contracting State of the business profits of an enterprise of the other Contracting State.

### *Paragraph 1*

Paragraph 1 states the general rule that business profits (as defined in paragraph 7) of an enterprise of one Contracting State may not be taxed by the other Contracting State unless the enterprise carries on business in that other Contracting State through a permanent establishment (as defined in Article 5 (Permanent Establishment)) situated there. When that condition is met, the State in which the permanent establishment is situated may tax the enterprise, but only on a net basis and only on the income that is attributable to the permanent establishment.

### *Paragraph 2*

Paragraph 2 provides rules for the attribution of business profits to a permanent establishment. The Contracting States will attribute to a permanent establishment the profits that it would have earned had it been an independent enterprise engaged in the same or similar activities under the same or similar circumstances. This language incorporates the arm's-length standard for purposes of determining the profits attributable to a permanent establishment. The computation of business profits attributable to a permanent establishment under this paragraph is subject to the rules of paragraph 3 for the allowance of expenses incurred for the purposes of earning the profits.

An exchange of notes between the Contracting States, signed at the time of the signing of the Convention, provides that if the information available to the tax authority of a Contracting State is not adequate to measure accurately the profits of a permanent establishment, the determination of profits in such cases may be made on a reasonable basis, based on the available information. This determination must be done consistently with the principles of this Article, i.e., it must seek to reflect arm's-length pricing and appropriate deductions of expenses.

The “attributable to” concept of paragraph 2 is analogous but not entirely equivalent to the “effectively connected” concept in Code section 864(c). The profits attributable to a permanent establishment may be from sources within or without a Contracting State.

It is understood that the business profits attributed to a permanent establishment include only those profits derived from that permanent establishment's assets or activities. This rule is consistent with the “asset-use” and “business activities” test of Code section 864(c)(2). Thus, the limited force of attraction rule of Code section 864(c)(3) is not incorporated into paragraph 2.

This Article does not contain a provision corresponding to paragraph 4 of Article 7 of the OECD Model. That paragraph provides that a Contracting State in certain circumstances may determine the profits attributable to a permanent establishment on the basis of an apportionment of the total profits of the enterprise. This paragraph has not been included in the Model because it is unnecessary. The OECD Commentary to paragraphs 2 and 3 of Article 7 authorize the use of profits methods independently of paragraph 4 of Article 7 of the OECD Model. Any such approach, however, must be designed to approximate an arm's-length result.

### *Paragraph 3*

Paragraph 3 provides that in determining the business profits of a permanent establishment, deductions shall be allowed for the expenses incurred for the purposes of the permanent establishment, ensuring that business profits will be taxed on a net basis. This rule is not limited to expenses incurred exclusively for the purposes of the permanent establishment, but includes a reasonable allocation of expenses incurred for the purposes of the enterprise as a whole, or that part of the enterprise that includes the permanent establishment. Deductions are to be allowed regardless of which accounting unit of the enterprise books the expenses, so long as they are incurred for the purposes of the permanent establishment. For example, a portion of the interest expense recorded on the books of the home office in one State may be deducted by a permanent establishment in the other if properly allocable thereto.

The paragraph specifies that the expenses that may be considered to be incurred for the purposes of the permanent establishment are expenses for research and development, interest and other similar expenses, as well as a reasonable amount of executive and general administrative expenses. This rule permits (but does not require) each Contracting State to apply the type of expense allocation rules provided by U.S. law such as in Treas. Reg. sections 1.861-8 and 1.882-5).

Paragraph 3 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. Similarly, a permanent establishment may not increase its business profits by the amount of any notional fees for ancillary services performed for another unit of the enterprise, but also should not receive a deduction for the expense of providing such services, since those expenses would be incurred for purposes of a business unit other than the permanent establishment.

### *Paragraph 4*

Paragraph 4 provides that no business profits can be attributed to a permanent establishment merely because it purchases goods or merchandise for the enterprise of which it is a part. This rule applies only to an office that performs functions for the enterprise in addition to purchasing. The income attribution issue does not arise if the sole activity of the permanent establishment is the purchase of goods or merchandise because such activity does not give rise to a permanent establishment under Article 5

(Permanent Establishment). A common situation in which paragraph 4 is relevant is one in which a permanent establishment purchases raw materials for the enterprise's manufacturing operation conducted outside the United States and sells the manufactured product. While business profits may be attributable to the permanent establishment with respect to its sales activities, no profits are attributable to it with respect to its purchasing activities.

#### *Paragraph 5*

This paragraph provides that profits shall be determined by the same method each year, unless there is good reason to change the method used. This rule assures consistent tax treatment over time for permanent establishments. It limits the ability of both the Contracting State and the enterprise to change accounting methods to be applied to the permanent establishment. It does not, however, restrict a Contracting State 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.

#### *Paragraph 6*

Paragraph 6 coordinates the provisions of Article 7 and other provisions of the Convention. Under this paragraph, when business profits include items of income that are dealt with separately under other articles of the Convention, the provisions of those articles will, except when they specifically provide to the contrary, take precedence over the provisions of Article 7. For example, the taxation of dividends will be determined by the rules of Article 10 (Dividends), and not by Article 7, except where, as provided in paragraph 5 of Article 10, the dividend is attributable to a permanent establishment or fixed base. In the latter case the provisions of Articles 7 or 15 (Independent Personal Services) apply. Thus, an enterprise of one State deriving dividends from the other State may not rely on Article 7 to exempt those dividends from tax at source if they are not attributable to a permanent establishment of the enterprise in the other State. By the same token, if the dividends are attributable to a permanent establishment in the other State, the dividends may be taxed on a net income basis at the source State's full corporate tax rate, rather than on a gross basis under Article 10 (Dividends).

As provided in Article 8 (Shipping and Air Transport), income derived from shipping and air transport activities in international traffic described in that Article is taxable only in the country of residence of the enterprise regardless of whether it is attributable to a permanent establishment situated in the source State.

#### *Paragraph 7*

The term "business profits" is defined in paragraph 7 to mean income derived from any trade or business. In accordance with this broad definition, the term "business profits" includes income attributable to notional principal contracts and other financial instruments to the extent that the income is attributable to a trade or business of dealing in such instruments, or is otherwise related to a trade or business (as in the case of a notional

principal contract entered into for the purpose of hedging currency risk arising from an active trade or business). Any other income derived from such instruments is, unless specifically covered in another article, dealt with under Article 22 (Other Income).

The paragraph states the longstanding U.S. view that income earned by an enterprise from the furnishing of personal services is business profits. Thus, a consulting firm resident in one State whose employees perform services in the other State through a permanent establishment may be taxed in that other State on a net basis under Article 7, and not under Article 15 (Independent Personal Services), which applies only to individuals. The salaries of the employees would be subject to the rules of Article 16 (Dependent Personal Services).

The paragraph also specifies that the term “business profits” includes income derived by an enterprise from the rental of tangible personal property. The inclusion of income derived by an enterprise from the rental of tangible personal property in business profits means that such income earned by a resident of a Contracting State can be taxed by the other Contracting State only if the income is attributable to a permanent establishment maintained by the resident in that other State, and, if the income is taxable, it can be taxed only on a net basis. Income from the rental of tangible personal property that is not derived in connection with a trade or business is dealt with in Article 22 (Other Income).

#### *Paragraph 8*

Paragraph 8 incorporates into the Convention the rule of Code section 864(c)(6). Like the Code section on which it is based, paragraph 8 provides that any income or gain attributable to a permanent establishment or a fixed base during its existence is taxable in the Contracting State where the permanent establishment or fixed base is situated, even if the payment of that income or gain is deferred until after the permanent establishment or fixed base ceases to exist. Paragraph 8 also provides that expenses attributable to the permanent establishment or fixed base during its existence may be deducted from the deferred income at such time as that income is subject to tax. This rule applies with respect to paragraphs 1 and 2 of Article 7 (Business Profits), paragraph 5 of Article 10 (Dividends), paragraph 4 of Articles 11 (Interest) and 12 (Royalties), paragraph 2 of Article 13 (Capital Gains), Article 15 (Independent Personal Services) and paragraph 2 of Article 22 Other Income).

The effect of this rule can be illustrated by the following example. Assume a company that is a resident of Bangladesh and that maintains a permanent establishment in the United States winds up the permanent establishment's business and sells the permanent establishment's inventory and assets to a U.S. buyer at the end of year 1 in exchange for an interest-bearing installment obligation payable in full at the end of year 3. Despite the fact that Article 13's threshold requirement for U.S. taxation is not met in year 3 because the company has no permanent establishment in the United States, the United States may tax the deferred income payment recognized by the company in year 3.

### *Relation to Other Articles*

This Article is subject to the saving clause of paragraph 2 of Article 1 (Personal Scope) of the Model. Thus, if a citizen of the United States who is a resident of Bangladesh under the treaty derives business profits from the United States that are not attributable to a permanent establishment in the United States, the United States may, subject to the special foreign tax credit rules of paragraph 3 of Article 23 (Relief from Double Taxation), tax those profits, notwithstanding the provision of paragraph 1 of this Article that would exempt the income from U.S. tax.

The benefits of this Article are also subject to Article 17 (Limitation on Benefits). Thus, an enterprise of Bangladesh that derives income effectively connected with a U.S. trade or business may not claim the benefits of Article 7 (Business Profits) unless the resident carrying on the enterprise qualifies for such benefits under Article 17.

## **ARTICLE 8 (SHIPPING AND AIR TRANSPORT)**

This Article governs the taxation of profits from the operation of ships and aircraft in international traffic. The term “international traffic” is defined in subparagraph 1(d) of Article 3 (General Definitions).

### *Paragraph 1*

Paragraph 1 provides that profits derived by an enterprise of a Contracting State from the operation in international traffic of ships or aircraft are taxable only in that Contracting State. Because paragraph 6 of Article 7 (Business Profits) defers to Article 8 with respect to shipping and air transport income, shipping and air transport income derived by a resident of one of the Contracting States may not be taxed in the other State even if the enterprise has a permanent establishment in that other State. Thus, if a U.S. airline has a ticket office in Bangladesh, Bangladesh may not tax the airline's profits attributable to that office under Article 7. Since entities engaged in international transportation activities normally will have many permanent establishments in a number of countries, the rule avoids difficulties that would be encountered in attributing income to multiple permanent establishments if the income were covered by Article 7.

### *Paragraph 2*

The income from the operation of ships or aircraft in international traffic that is exempt from tax under paragraph 1 is defined in paragraph 2.

In addition to income derived directly from the operation of ships or aircraft in international traffic, this definition also includes certain items of rental income that are closely related to those activities. Income of an enterprise of a Contracting State from the rental of ships or aircraft on a full basis (i.e., with crew) or bareboat basis is exempt from tax in the other Contracting State under paragraph 1, when such ships or aircraft are operated in international traffic by the lessee, or when the income is incidental to other

income of the lessor from the operation of ships or aircraft in international traffic. The exemption under paragraph 1 of income from the operation of ships or aircraft in international traffic is broader than that of the OECD Model as it covers rentals from bareboat leasing that are not incidental to the operation of aircraft by the resident itself.

Finally, certain non-transport activities that are an integral part of the services performed by a transport company are understood to be covered in paragraph 1, though they are not specified in paragraph 2. These include, for example, the performance of some maintenance or catering services by one airline for another airline, if these services are incidental to the provision of those services by the airline for itself. Income earned by concessionaires, however, is not covered by Article 8. See paragraphs 4 of the Commentary to Article 8 of the OECD Model.

### Paragraph 3

Under this paragraph, profits of an enterprise of a Contracting State from the rental or maintenance of containers (including trailers, barges and related equipment for the transport of containers) that are used for the transport of goods in international traffic are exempt from tax in the other Contracting State. This result obtains under paragraph 3 regardless of whether the recipient of the income is engaged in the operation of ships or aircraft in international traffic, and regardless of whether the enterprise has a permanent establishment in the other Contracting State. By contrast, Article 8 of the OECD Model covers only income from the use, maintenance or rental of containers that is incidental to other income from international traffic.

### *Paragraph 4*

This paragraph clarifies that the provisions of paragraphs 1, 3 and 4 also apply to profits derived by an enterprise of a Contracting State 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. For example, airlines from two countries may agree to share the transport of passengers between the two countries. They each will fly the same number of flights per week and share the revenues from that route equally, regardless of the number of passengers that each airline actually transports. Paragraph 4 makes clear that with respect to each carrier the income dealt with in the Article is that carrier's share of the total transport, not the income derived from the passengers actually carried by the airline.

### *Relation to Other Articles*

The taxation of gains from the alienation of ships, aircraft or containers is not dealt with in this Article but in paragraph 4 of Article 13 (Capital Gains).

As with other benefits of the Convention, the benefit of exclusive residence country taxation or limited source country taxation under Article 8 is available to an enterprise only if it is entitled to benefits under Article 17 (Limitation on Benefits).



This Article also is subject to the saving clause of paragraph 2 of Article 1 (Personal Scope) of the Model. Thus, if a citizen of the United States who is a resident of Bangladesh derives profits from the operation of aircraft in international traffic, notwithstanding the exclusive residence country taxation in paragraph 1 of Article 8, the United States may, subject to the special foreign tax credit rules of paragraph 3 of Article 23 (Relief from Double Taxation), tax those profits as part of the worldwide income of the citizen. (This is an unlikely situation, however, because non-tax considerations (e.g., insurance) generally result in shipping activities being carried on in corporate form.)

## **ARTICLE 9 (ASSOCIATED ENTERPRISES)**

This Article incorporates in the Convention the arm's-length principle reflected in the U.S. domestic transfer pricing provisions, particularly Code section 482. It provides that when related enterprises engage in a transaction on terms that are not arm's-length, the Contracting States may make appropriate adjustments to the taxable income and tax liability of such related enterprises to reflect what the income and tax of these enterprises with respect to the transaction would have been had there been an arm's-length relationship between them.

### *Paragraph 1*

This paragraph is essentially the same as its counterpart in the OECD Model. It addresses the situation where an enterprise of a Contracting State is related to an enterprise of the other Contracting State, and there are arrangements or conditions imposed between the enterprises in their commercial or financial relations that are different from those that would have existed in the absence of the relationship. Under these circumstances, the Contracting States may adjust the income (or loss) of the enterprise to reflect what it would have been in the absence of such a relationship.

The paragraph identifies the relationships between enterprises that serve as a prerequisite to application of the Article. As the Commentary to the OECD Model makes clear, the necessary element in these relationships is effective control, which is also the standard for purposes of section 482. Thus, the Article applies if an enterprise of one State participates directly or indirectly in the management, control, or capital of the enterprise of the other State. Also, the Article applies if any third person or persons participate directly or indirectly in the management, control, or capital of enterprises of different States. For this purpose, all types of control are included, i.e., whether or not legally enforceable and however exercised or exercisable.

The fact that a transaction is entered into between such related enterprises does not, in and of itself, mean that a Contracting State may adjust the income (or loss) of one or both of the enterprises under the provisions of this Article. If the conditions of the transaction are consistent with those that would be made between independent persons, the income arising from that transaction should not be subject to adjustment under this Article.

Similarly, the fact that associated enterprises may have concluded arrangements, such as cost sharing arrangements or general services agreements, is not in itself an indication that the two enterprises have entered into a non-arm's-length transaction that should give rise to an adjustment under paragraph 1. Both related and unrelated parties enter into such arrangements (e.g., joint ventures may share some development costs). As with any other kind of transaction, when related parties enter into an arrangement, the specific arrangement must be examined to see whether or not it meets the arm's-length standard. In the event that it does not, an appropriate adjustment may be made, which may include modifying the terms of the agreement or recharacterizing the transaction to reflect its substance.

It is understood that the “commensurate with income” standard for determining appropriate transfer prices for intangibles, added to Code section 482 by the Tax Reform Act of 1986, was designed to operate consistently with the arm's-length standard. The implementation of this standard in the section 482 regulations is in accordance with the general principles of paragraph 1 of Article 9 of the Convention, as interpreted by the OECD Transfer Pricing Guidelines.

This Article also permits tax authorities to deal with thin capitalization issues. They may in the context of Article 9, scrutinize more than the rate of interest charged on a loan between related persons. They also may examine the capital structure of an enterprise, whether a payment in respect of that loan should be treated as interest, and, if it is treated as interest, under what circumstances interest deductions should be allowed to the payor. Paragraph 2 of the Commentary to Article 9 of the OECD Model, together with the U.S. observation set forth in paragraph 15, sets forth a similar understanding of the scope of Article 9 in the context of thin capitalization.

#### *Paragraph 2*

When a Contracting State has made an adjustment that is consistent with the provisions of paragraph 1, and the other Contracting State agrees that the adjustment was appropriate to reflect arm's-length conditions, that other Contracting State is obligated to make a correlative adjustment (sometimes referred to as a “corresponding adjustment”) to the tax liability of the related person in that other Contracting State. Although the OECD Model does not specify that the other Contracting State must agree with the initial adjustment before it is obligated to make the correlative adjustment, the Commentary to Article 9 makes clear that the paragraph is to be read that way.

As explained in the OECD Commentary, Article 9 leaves the treatment of “secondary adjustments” to the laws of the Contracting States. When an adjustment under Article 9 has been made, one of the parties will have in its possession funds that it would not have had at arm's length. The question arises as to how to treat these funds. In the United States the general practice is to treat such funds as a dividend or contribution to capital, depending on the relationship between the parties. Under certain circumstances, the parties may be permitted to restore the funds to the party that would have the funds at

arm's length, and to establish an account payable pending restoration of the funds. See, Rev. Proc. 99-32, 1999-2 C.B. 296.

The Contracting State making a secondary adjustment will take the other provisions of the Convention, where relevant, into account. For example, if the effect of a secondary adjustment is to treat a U.S. corporation as having made a distribution of profits to its parent corporation in Bangladesh, the provisions of Article 10 (Dividends) will apply, and the United States may impose a 10 percent withholding tax on the dividend. Also since under Article 23 (Relief from Double Taxation) Bangladesh is required to give a credit for taxes paid with respect to such dividends, it would also be required to do so in this case.

The competent authorities are authorized by paragraph 2 to consult, if necessary, to resolve any differences in the application of these provisions. For example, there may be a disagreement over whether an adjustment made by a Contracting State under paragraph 1 was appropriate.

If a correlative adjustment is made under paragraph 2, it is to be implemented, pursuant to paragraph 2 of Article 25 (Mutual Agreement Procedure), notwithstanding any time limits or other procedural limitations in the law of the contracting State making the adjustment. If a taxpayer has entered a closing agreement (or other written settlement) with the United States prior to bringing a case to the competent authorities, the U.S. competent authority will endeavor only to obtain a correlative adjustment from the other Contracting State. See, Rev. Proc. 2002-52, 2002-31 I.R.B. 242, Section 7.04.

### *Paragraph 3*

Paragraph 3 preserves the right of Contracting States to apply internal law provisions relating to adjustments between related parties. They also reserve the right to make adjustments in cases involving tax evasion or fraud. Such adjustments -- the distribution, apportionment, or allocation of income, deductions, credits or allowances -- are permitted even if they are different from, or go beyond, those authorized by paragraph 1 of the Article, as long as they accord with the general principles of paragraph 1 (i.e., that the adjustment reflects what would have transpired had the related parties been acting at arm's length). For example, while paragraph 1 explicitly allows adjustments of deductions in computing taxable income, it does not deal with adjustments to tax credits. It does not, however, preclude such adjustments if they can be made under internal law. The provision does not grant authority not otherwise present under internal law. The OECD Model reaches the same result. See paragraph 4 of the Commentary to Article 9.

### *Relationship to other Articles*

The saving clause of paragraph 2 of Article 1 (Personal Scope) does not apply to paragraph 2 of Article 9 by virtue of the exceptions to the saving clause in paragraph 3 (a) of Article 1. Thus, even if the statute of limitations has run, a refund of tax can be made in order to implement a correlative adjustment. Statutory or procedural limitations,

however, cannot be overridden to impose additional tax, because paragraph 2 of Article 27 (Effect of Convention on Diplomatic Agents and Consular Officers, Domestic Laws and Other Treaties) provides that the Convention cannot restrict any statutory benefit.

## **ARTICLE 10 (DIVIDENDS)**

Article 10 provides rules for the taxation of dividends paid by a resident of one Contracting State to a beneficial owner that is a resident of the other Contracting State.

### *Paragraph 1*

The right of a shareholder's country of residence to tax dividends arising in the source country is preserved by paragraph 1, which permits a Contracting State to tax its residents on dividends paid to them by a resident of the other Contracting State. For dividends from any other source paid to a resident, Article 22 (Other Income) grants the residence country exclusive taxing jurisdiction (other than for dividends attributable to a permanent establishment or fixed base in the other State).

### *Paragraph 2*

The State of source may also tax dividends beneficially owned by a resident of the other State, subject to the limitations in paragraph 2. Generally, the source State's tax is limited to 15 percent of the gross amount of the dividend paid. If, however, the beneficial owner of the dividends is a company resident in the other State that owns at least 10 percent of the voting stock of the company paying the dividend, then the source State's tax is limited to 10 percent of the gross amount of the dividend. Indirect ownership of voting shares (through tiers of corporations) are taken into account for purposes of determining eligibility for the 10 percent direct dividend rate.

Shares are considered voting shares if they provide the power to elect, appoint or replace any person vested with the powers ordinarily exercised by the board of directors of a U.S. corporation.

The benefits of paragraph 2 may be granted at the time of payment by means of reduced withholding at source. It also is consistent with the paragraph for tax to be withheld at the time of payment at full statutory rates, and the treaty benefit to be granted by means of a subsequent refund so long as such procedures are applied in a reasonable manner.

Paragraph 2 does not affect the taxation of the profits out of which the dividends are paid. The taxation by a Contracting State of the income of its resident companies is governed by the internal law of the Contracting State, subject to the provisions of paragraph 4 of Article 24 (Nondiscrimination).

The term "beneficial owner" is not defined in the Convention, and is, therefore, defined as under the internal law of the country imposing tax (i.e., the source country).

The beneficial owner of the dividend for purposes of Article 10 is the person to which the dividend income is attributable for tax purposes under the laws of the source State. Thus, if a dividend paid by a corporation that is a resident of one of the States (as determined under Article 4 (Fiscal Domicile)) is received by a nominee or agent that is a resident of the other State on behalf of a person that is not a resident of that other State, the dividend is not entitled to the benefits of this Article. However, a dividend received by a nominee on behalf of a resident of that other State would be entitled to benefits. These limitations are confirmed by paragraph 12 of the OECD Commentary to Article 10. See also paragraph 24 of the OECD Commentary to Article 1 (Personal Scope).

Companies holding shares through fiscally transparent entities such as partnerships are considered for purposes of this paragraph to hold their proportionate interest in the shares held by the intermediate entity. As a result, companies holding shares through such entities may be able to claim the benefits of subparagraph (a) under certain circumstances. The lower rate applies when the company's proportionate share of the shares held by the intermediate entity meets the 10 percent voting stock threshold. Whether this ownership threshold is satisfied may be difficult to determine and often will require an analysis of the partnership or trust agreement.

### *Paragraph 3*

Paragraph 3 provides rules that modify the maximum rates of tax at source provided in paragraph 2 in particular cases. The first sentence of paragraph 3 denies the lower direct investment withholding rate of paragraph 2(a) for dividends paid by a RIC or a REIT. The second sentence states that dividends paid by a RIC will qualify for the 15 percent rate provided by subparagraph 2(b).

The third sentence denies the benefits of both subparagraphs (a) and (b) of paragraph 2 to dividends paid by REITs in certain circumstances, allowing them to be taxed at the U.S. statutory rate (30 percent). The United States limits the source tax on dividends paid by a REIT to the 15 percent rate only when the beneficial owner of the dividend satisfies one or more of three criteria. First, the dividend may qualify if the beneficial owner is an individual resident of the other State who owns not more than 10 percent interest in the REIT. Second, the dividend may qualify for the 15 percent rate if it is paid with respect to a class of stock that is publicly traded and the beneficial owner of the dividends is a person holding an interest of not more than 5 percent of any class of the REIT's stock. Finally, the dividend may qualify for the 15 percent rate if 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.

For this purpose, a REIT will be considered 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. For the purposes of this rule, foreclosure property shall not be considered an interest in real property. Where a REIT holds an interest in a partnership, it shall be treated as owning directly a proportion of the partnership's interests in real property corresponding to its interest in the partnership. Mortgages will not be considered an

interest in real property unless, in the case of a mortgage, it has substantial equity components.

The denial of the 10 percent withholding rate at source to all RIC and REIT shareholders, and the denial of the 15 percent rate to REIT shareholders that do not meet one of the 3 tests described above, is intended to prevent the use of these entities to gain unjustifiable source taxation benefits for certain shareholders resident in the other Contracting State. For example, a corporation resident in Bangladesh that wishes to hold a diversified portfolio of U.S. corporate shares may hold the portfolio directly and pay a U.S. withholding tax of 15 percent on all of the dividends that it receives. Alternatively, it may acquire a diversified portfolio by purchasing a 10 percent or more of the interests in a RIC. Since the RIC may be a pure conduit, there may be no U.S. tax costs to interposing the RIC in the chain of ownership. Absent the special rule in paragraph 3, such use of the RIC could transform portfolio dividends, taxable in the United States under the Convention at 15 percent, into direct investment dividends taxable only at 10 percent.

Similarly, a resident of Bangladesh directly holding U.S. real property would pay U.S. tax either at a 30 percent rate on the gross income or at graduated rates on the net income. As in the preceding example, by placing the real property in a REIT, the investor could transform real estate income into dividend income, taxable at the rates provided in Article 10, significantly reducing the U.S. tax that otherwise would be imposed. This policy avoids a disparity between the taxation of direct real estate investments and real estate investments made through REIT conduits. In the cases covered by the exceptions, the holding in the REIT is not considered the equivalent of a direct holding in the underlying real property.

#### *Paragraph 4*

Paragraph 4 defines the term dividends broadly and flexibly. The definition is intended to cover all arrangements that yield a return on an equity investment in a corporation as determined under the tax law of the state of source, as well as arrangements that might be developed in the future.

The term dividends include income from shares or other rights that are not debt-claims and that participate in profits. It also includes income derived from other corporate rights that is subjected to the same taxation treatment as income from shares by the domestic taxation laws of the Contracting State of which the company making the distribution is a resident. Thus, a constructive dividend that results from a non-arm's-length transaction between a corporation and a related party is a dividend. The term "dividends" further specifically includes income from arrangements (including instruments denominated as debt claims) that carry the right to participate in profits, or that are determined by reference to profits, to the extent the income from the arrangement is characterized as a dividend under the law of the Contracting State in which the income arises.

In general, this definition has the effect of deferring to the source State's characterization of income as a dividend. It ensures, for example, that a payment denominated as interest that is made by a thinly capitalized corporation may be treated as a dividend to the extent that the debt is recharacterized as equity under the laws of the source State. In the case of the United States, the term "dividend" also includes amounts treated as a dividend under U.S. law upon the sale or redemption of shares or upon a transfer of shares in a reorganization. See, e.g., Rev. Rul. 92-85, 1992-40 I.R.B. 10 (sale of foreign subsidiary's stock to U.S. sister company is a deemed dividend to extent of subsidiary's and sister's earnings and profits). Further, a distribution from a U.S. publicly traded limited partnership, which is taxed as a corporation under U.S. law, is a dividend for purposes of Article 10. However, a distribution by a limited liability company ("LLC") is not recognized by the United States as a dividend and, therefore, is not a dividend for purposes of Article 10, provided the LLC is not characterized as an association taxable as a corporation under U.S. law.

#### *Paragraph 5*

Paragraph 5 excludes from the general source country limitations under paragraph 2 dividends paid with respect to holdings that form part of the business property of a permanent establishment or a fixed base. Such dividends will be taxed on a net basis using the rates and rules of taxation generally applicable to residents of the State in which the permanent establishment or fixed base is situated, as modified by the Convention. An example of dividends paid with respect to the business property of a permanent establishment would be dividends derived by a dealer in stock or securities from stock or securities that the dealer held for sale to customers. In the case of a permanent establishment or fixed base that once existed in the State but that no longer exists, the provisions of this paragraph 5 also apply, by virtue of paragraph 8 of Article 7 (Business Profits), to dividends that would be attributable to such a permanent establishment or fixed base if it did exist in the year of payment or accrual. See the Technical Explanation of paragraph 8 of Article 7.

#### *Relation to Other Articles*

Notwithstanding the foregoing limitations on source country taxation of dividends, the saving clause of paragraph 2 of Article 1 (Personal Scope) permits the United States to tax dividends received by its residents and citizens, subject to the special foreign tax credit rules of paragraph 3 of Article 23 (Relief from Double Taxation), as if the Convention had not come into effect.

The benefits of this Article are also subject to the provisions of Article 17 (Limitation on Benefits). Thus, if a resident of Bangladesh is the beneficial owner of dividends paid by a U.S. corporation, the shareholder must qualify for treaty benefits under at least one of the tests of Article 17 in order to receive the benefits of this Article.

The branch tax, normally dealt with in Article 10, is dealt with in Article 14 (Branch Tax) in this Convention.

## **ARTICLE 11 (INTEREST)**

Article 11 provides rules for the taxation of interest income arising in one Contracting State and paid to a beneficial owner that is a resident of the other Contracting State.

### *Paragraph 1*

Paragraph 1 grants to both Contracting States the right to tax interest derived by a resident of one State from sources in the other. Paragraphs 2 and 3 contain rules that limit the source State's right to tax such interest payments. For interest derived by a resident of a Contracting State from sources in any third state, Article 22 (Other Income) grants the residence country exclusive taxing jurisdiction (other than for interest attributable to a permanent establishment or fixed base in the other State).

### *Paragraph 2*

Paragraph 2 grants to the source State the right to tax interest payments beneficially owned by a resident of the other State. The general rate of source country tax applicable to interest payments under paragraph 2 is limited to 10 percent. Under the provisions of paragraph 3, the rate is modified for certain categories of interest, some of which are exempt from source country tax.

The reduced rates of withholding tax, or exemption, of paragraphs 2 and 3 may be granted at the time of payment by means of reduced withholding at source. It also is consistent with the paragraphs for tax to be withheld at the time of payment at full statutory rates, and the treaty benefit to be granted by means of a subsequent refund so long as such procedures are applied in a reasonable manner.

The term “beneficial owner” is not defined in the Convention, and is, therefore, defined as under the internal law of the country imposing tax (i.e., the source country). The beneficial owner of the interest for purposes of Article 11 is the person to which the interest income is attributable for tax purposes under the laws of the source State. Thus, if interest arising in a Contracting State is received by a nominee or agent that is a resident of the other State on behalf of a person that is not a resident of that other State, the interest is not entitled to the benefits of this Article. However, interest received by a nominee on behalf of a resident of that other State would be entitled to benefits. These limitations are confirmed by paragraph 8 of the OECD Commentary to Article 11. See also paragraph 24 of the OECD Commentary to Article 1 (Personal Scope).

### *Paragraph 3*

Paragraph 3 specifies certain categories of interest that are either exempt from source State taxation or are subject to tax at a rate lower than the 10 percent rate provided for in paragraph 2. Subparagraph 3(a) exempts interest arising in one Contracting State



and paid to the Government of the other Contracting State or an instrumentality of that Government. The term “instrumentality” includes the central banks of the Contracting States (i.e., The Bangladesh Bank or any Federal Reserve Bank of the United States), and the U.S. Export-Import Bank and the Overseas Private Investment Corporation. Other institutions may be added to the category of “instrumentality” by mutual agreement of the competent authorities of the Contracting States. Paragraph 3(a) also provides a source-state exemption for interest arising in a Contracting State on a debt obligation that is guaranteed or insured by that Contracting State or an instrumentality of that State.

Subparagraph 3(b) provides for a maximum rate of tax at source of 5 percent on interest derived from sources in one Contracting State that is beneficially owned by a bank or other financial institution, including an insurance company, resident in the other Contracting State.

Subparagraph 3(c) provides for a 5 percent rate of tax at source on interest derived from sources in one Contracting State that is beneficially owned by a resident in the other Contracting State in connection with a sale on credit to an enterprise of the first-mentioned State of industrial, commercial or scientific equipment or of any other merchandise.

#### *Paragraph 4*

Paragraph 4 provides an exception to the limited source country taxation rules of paragraphs 2 and 3 in cases where the beneficial owner of the interest carries on business through a permanent establishment in the State of source or performs independent personal services from a fixed base situated in that State and the debt-claim in respect of which the interest is paid is effectively connected with that permanent establishment or fixed base. In such cases the provisions of Article 7 (Business Profits) or Article 15 (Independent Personal Services) will apply and the State of source will retain the right to impose tax on such interest income.

In the case of a permanent establishment or fixed base that once existed in the State but that no longer exists, the provisions of paragraph 4 also apply, by virtue of paragraph 8 of Article 7 (Business Profits), to interest that would be attributable to such a permanent establishment or fixed base if it did exist in the year of payment or accrual. See the Technical Explanation of paragraph 8 of Article 7.

#### *Paragraph 5*

Although worded differently, paragraph 5 is the same in substance as paragraph 5 of the U.S. Model. The paragraph provides that in cases involving special relationships between persons, Article 11 applies only to that portion of the total interest payments between such persons that would have been made absent such special relationships (i.e., an arm's-length interest payment). Any excess amount of interest paid remains taxable according to the laws of the United States and Bangladesh, respectively, with due regard to the other provisions of the Convention. Thus, if the excess amount would be treated

under the source country's law as a distribution of profits by a corporation, such amount could be taxed as a dividend rather than as interest, but the tax would be subject, if appropriate, to the rate limitations of paragraph 2 of Article 10 (Dividends).

The term “related person” is not defined in the Convention. In applying this paragraph the United States considers the term to include the relationships described in Article 9, which in turn corresponds to the definition of “control” for purposes of section 482 of the Code.

This paragraph does not address cases where, owing to a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest is less than an arm's-length amount. In those cases a transaction may be characterized to reflect its substance and interest may be imputed consistent with the definition of interest in paragraph 6. The United States would apply section 482 or 7872 of the Code to determine the amount of imputed interest in those cases.

#### *Paragraph 6*

The term “interest” as used in Article 11 is defined in paragraph 6, for purposes of the Convention, to include, inter alia, income from debt claims of every kind, whether or not secured by a mortgage. Interest that is paid or accrued subject to a contingency is within the ambit of Article 11, although it is dealt with in paragraph 7, not paragraph 6. The term includes income from a debt obligation carrying the right to participate in profits. The term does not, however, include amounts that are treated as dividends under Article 10 (Dividends).

The term interest also includes amounts subject to the same tax treatment as income from money lent under the law of the State in which the income arises. Thus, for purposes of the Convention, amounts that the United States will treat as interest include (i) the difference between the issue price and the stated redemption price at maturity of a debt instrument, i.e., original issue discount (OID), which may be wholly or partially realized on the disposition of a debt instrument (section 1273), (ii) amounts that are imputed interest on a deferred sales contract (section 483), (iii) amounts treated as OID under the stripped bond rules (section 1286), (iv) amounts treated as original issue discount under the below market interest rate rules (section 7872), (v) a partner's distributive share of a partnership's interest income (section 702), (vi) the interest portion of periodic payments made under a “finance lease” or similar contractual arrangement that in substance is a borrowing by the nominal lessee to finance the acquisition of property, (vii) amounts included in the income of a holder of a residual interest in a REMIC (section 860E), because these amounts generally are subject to the same taxation treatment as interest under U.S. tax law, and (viii) interest with respect to notional principal contracts that are recharacterized as loans because of a “substantial non-periodic payment”.

### *Paragraph 7*

Paragraph 7 provides anti-abuse exceptions to the rules provided in paragraphs 2 and 3 for two classes of interest payments. The first exception, subparagraph (a) of paragraph 7, is consistent with the policy of Code sections 860E(e) and 860G(b) that excess inclusions with respect to a REMIC should bear full source country tax in all cases. Without a full tax at source on such income arising in the United States, foreign purchasers of residual interests would have a competitive advantage over U.S. purchasers at the time these interests are initially offered. Also, absent this rule the United States fisc would suffer a revenue loss with respect to mortgages held in a REMIC because of opportunities for tax avoidance created by differences in the timing of taxable and economic income produced by these interests.

The second exception, in subparagraph 5(b), deals with contingent interest of type that does not qualify as portfolio interest under U.S. law and to analogous types of interest under Bangladesh law. Under this provision, interest arising in one of the Contracting States that is determined by reference to the receipts, sales, income, profits or other cash flow of the debtor or a related person, to any change in the value of any property of the debtor or, a related person or to any dividend, partnership distribution or similar payment made by the debtor or a related person, and paid to a resident of the other State may also be taxed in the Contracting State in which it arises, and according to the laws of that State, but if the beneficial owner is a resident of the other Contracting State, the gross amount of the interest may be taxed at a rate not exceeding the rate prescribed in subparagraph (b) of paragraph 2 of Article 10 (Dividends).

### *Paragraph 8*

Paragraph 8 provides the rule for determining the source of interest. Interest is considered to arise in a Contracting State if paid by a resident of that State, which, as defined in Article 4 (Fiscal Domicile), includes that State itself and its political subdivisions or local authorities. If, however, interest is borne by a permanent establishment or fixed base in one of the States, that interest is considered to arise in that State. For this purpose, interest is considered to be borne by a permanent establishment or fixed base if it is allocable to taxable income of that permanent establishment or fixed base.

### *Relation to Other Articles*

Notwithstanding the foregoing limitations on source country taxation of interest, the saving clause of paragraph 2 of Article 1 (Personal Scope) permits the United States to tax its residents and citizens, subject to the special foreign tax credit rules of paragraph 3 of Article 23 (Relief from Double Taxation), as if the Convention had not come into force.

As with other benefits of the Convention, the benefits of reduced source State taxation of interest under Article 11 are available to a resident of the other State only if

that resident is entitled to those benefits under the provisions of Article 17 (Limitation on Benefits).

## **ARTICLE 12 (ROYALTIES)**

Article 12 provides rules for the taxation of royalties arising in one Contracting State and paid to a beneficial owner that is a resident of that other Contracting State.

### *Paragraph 1*

Paragraph 1 grants to both Contracting States the right to tax royalties derived by a resident of one State from sources in the other. Paragraph 2 contains rules that limit the source State's right to tax such royalty payments. For interest derived by a resident of a Contracting State from sources in any third state, Article 22 (Other Income) grants the residence country exclusive taxing jurisdiction (other than for royalty attributable to a permanent establishment or fixed base in the other State).

### *Paragraph 2*

Paragraph 2 allows the State where the royalty arises, as defined in paragraph 5, to tax the royalty. If, however, the beneficial owner of the royalty is a resident of the other Contracting State, the tax may not exceed 10 percent of the gross amount of the royalties.

The term “beneficial owner” is not defined in the Convention, and is, therefore, defined as under the internal law of the country imposing tax (i.e., the source country). The beneficial owner of a royalty payment for purposes of Article 13 refers to the person to which the royalty income is attributable for tax purposes under the laws of the source State. Thus, if a royalty arising in a Contracting State is received by a nominee or agent that is a resident of the other State on behalf of a person that is not a resident of that other State, the royalty is not entitled to the benefits of this Article. However, a royalty received by a nominee on behalf of a resident of that other State would be entitled to benefits. These limitations are confirmed by paragraph 4 of the OECD Commentary to Article 12. See also paragraph 24 of the OECD Commentary to Article 1 (Personal Scope).

### *Paragraph 3*

The term “royalties” as used in Article 12 is defined in paragraph 3 to include payments of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic, or scientific work including cinematographic films or tapes used for radio or television broadcasting, and 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. It does not include income from leasing personal property, nor does it include payments in consideration for the

working of, or the right to work, mineral deposits, sources or other natural resources. The term “royalties” also includes gain derived from the alienation of any right or property that would give rise to royalties, to the extent the gain is contingent on the productivity, use, or further alienation thereof. Gains that are not so contingent are dealt with under Article 13 (Capital Gains).

The term royalties is defined in the Convention and therefore is generally independent of domestic law. Certain terms used in the definition are not defined in the Convention, but these may be defined under domestic tax law. For example, the term “secret process or formulas” is found in the Code, and its meaning has been elaborated in the context of sections 351 and 367. See Rev. Rul., 55-17, 1955-1 C.B. 388; Rev. Rul. 64-56, 1964-1 C.B. 133; Rev. Proc. 69-19, 1969-2 C.B. 301.

Consideration for the use or right to use cinematographic films, or works on film, tape, or other means of reproduction in radio or television broadcasting is specifically included in the definition of royalties. It is intended that subsequent technological advances in the field of radio and television broadcasting will not affect the inclusion of payments relating to the use of such means of reproduction in the definition of royalties.

If an artist who is resident in one Contracting State records a performance in the other Contracting State, retains a copyrighted interest in a recording, and receives payments for the right to use the recording based on the sale or public playing of the recording, then the right of such other Contracting State to tax those payments is governed by Article 12. See *Boulez v. Commissioner*, 83 T.C. 584 (1984), *aff'd*, 810 F.2d 20(D.C. Cir. 1986). By contrast, if the artist earns in the other Contracting State income covered by Article 18 (Entertainers and Athletes), for example, endorsement income from the artist’s attendance at a film screening, and if such income also is attributable to one of the rights described in Article 12 (e.g., the use of the artist’s photograph in promoting the screening), Article 18 and not Article 12 is applicable to such income.

Computer software generally is protected by copyright laws around the world. Under the Convention consideration received for the use or the right to use computer software is treated either as royalties or as business profits, depending on the facts and circumstances of the transaction giving rise to the payment.

The term “industrial, commercial, or scientific experience” (sometimes referred to as “know-how”) has the meaning ascribed to it in paragraph 11 of the Commentary to Article 12 of the OECD Model Convention. Consistent with that meaning, the term may include information that is ancillary to a right otherwise giving rise to royalties, such as a patent or secret process.

Know-how also may include, in limited cases, technical information that is conveyed through technical or consultancy services. It does not include general educational training of the user's employees, nor does it include information developed especially for the user, for example, a technical plan or design developed according to the user's specifications. Thus, as provided in paragraph 11 of the Commentary to Article 12

of the OECD Model, the term “royalties” does not include payments received as consideration for after-sales service, for services rendered by a seller to a purchaser under a guarantee, or for pure technical assistance.

The term “royalties” also does not include payments for professional services (such as architectural, engineering, legal, managerial, medical, software development services). For example, income from the design of a refinery by an engineer (even if the engineer employed know-how in the process of rendering the design) or the production of a legal brief by a lawyer is not income from the transfer of know-how taxable under Article 12, but is income from services taxable under either Article 15 (Independent Personal Services) or Article 16 (Dependent Personal Services). Professional services may be embodied in property that gives rise to royalties, however. Thus, if a professional contracts to develop patentable property and retains rights in the resulting property under the development contract, subsequent license payments made for those rights would be royalties.

#### *Paragraph 4*

This paragraph provides an exception to the rule of paragraph 2 that gives the state of source limited taxing jurisdiction. That exception applies in cases where the beneficial owner of the royalties carries business through a permanent establishment in the state of source or performs independent personal services from a fixed base situated in that state and the right or property in respect of which the royalties are paid are effectively connected with that permanent establishment or fixed base. In such cases the provisions of Article 7 (Business Profits) or Article 15 (Independent Personal Services) will apply.

In the case of a permanent establishment or fixed base that once existed in the State but that no longer exists, the provisions of paragraph 4 also apply, by virtue of paragraph 8 of Article 7 (Business Profits), to interest that would be attributable to such a permanent establishment or fixed base if it did exist in the year of payment or accrual. See the Technical Explanation of paragraph 8 of Article 7.

#### *Paragraph 5*

Paragraph 5 provides that in cases involving special relationships between the payor and beneficial owner of royalties, Article 12 applies only to the extent the royalties would have been paid absent such special relationships (i.e., an arm's-length royalty). Any excess amount of royalties paid remains taxable according to the laws of the two Contracting States with due regard to the other provisions of the Convention. If, for example, the excess amount is treated as a distribution of corporate profits under domestic law, such excess amount will be taxed as a dividend rather than as royalties, but the tax imposed on the dividend payment will be subject to the rate limitations of paragraph 2 of Article 10 (Dividends)

### *Paragraph 6*

Paragraph 6 provides a source rule for royalties. Under this provision, royalties shall be deemed to arise in a Contracting State when they are in consideration for the use of, or the right to use, property, information or experience in that State. This source rule is in general accord with the “place-of-use” test of section 861(a)(4) of the Code.

### *Relation to Other Articles*

Notwithstanding the foregoing limitations on source country taxation of royalties, the saving clause of paragraph 2 of Article 1 (Personal Scope) permits the United States to tax its residents and citizens, subject to the special foreign tax credit rules of paragraph 3 of Article 23 (Relief from Double Taxation), as if the Convention had not come into force.

As with other benefits of the Convention, the benefits of limited source State taxation of royalties under paragraph 2 of Article 12 are available to a resident of the other State only if that resident is entitled to those benefits under Article 17 (Limitation on Benefits).

## **ARTICLE 13 (CAPITAL GAINS)**

Article 13 assigns either primary or exclusive taxing jurisdiction over gains from the alienation of property to the State of residence or the State of source and defines the terms necessary to apply the Article.

### *Paragraph 1*

Subparagraph 1(a) of Article 13 preserves the non-exclusive right of the State of source to tax gains attributable to the alienation of immovable property situated in that State. The paragraph therefore permits the United States to apply section 897 of the Code to tax gains derived by a resident of the other Contracting State that are attributable to the alienation of real property situated in the United States (as defined in subparagraph 1(b)). Gains attributable to the alienation of real property include gain from any other property that is treated as a real property interest within the meaning of subparagraph 1(b). As in Article 6 (Income from Immovable Property), the use of the term “immovable property” in this paragraph is intended to have the same meaning as the term “real property.”

Subparagraph 1(b) defines the term “immovable property” for purposes of this paragraph. The term includes real property referred to in Article 6 (Income from Immovable Property) (i.e., an interest in the real property itself). It also includes a “United States real property interest,” when the United States is the other Contracting State under subparagraph (a). When Bangladesh is the other Contracting State, the term also includes shares of stock of a company the property of which consists principally of immovable property situated in Bangladesh.

Under section 897(c) of the Code the term “United States real property interest” includes shares in a U.S. corporation that owns sufficient U.S. real property interests to satisfy an asset-ratio test on certain testing dates. The term also includes certain foreign corporations that have elected to be treated as US corporations for this purpose. Section 897(i).

In applying paragraph 1, the United States will look through certain distributions made by a REIT or RIC. Accordingly, distributions made by a REIT or RIC are taxable under paragraph 1 of Article 13 (not under Article 10 (Dividends)) when they are attributable to gains derived from the alienation of real property. However, a distribution made by a REIT with respect to a class of stock publicly traded on an established securities market located in the United States is not treated as gain from the sale or exchange of a U.S. real property interest if the shareholder did not own more than 5 percent of the class of stock during the taxable year.

### *Paragraph 2*

Paragraph 2 of Article 13 deals with the taxation of certain gains from the alienation of movable property forming part of the business property of a permanent establishment that an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services. This also includes gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base. Such gains may be taxed in the State in which the permanent establishment or fixed base is located.

The term “movable property” has the same meaning as the term “personal property.”

A resident of Bangladesh that is a partner in a partnership doing business in the United States generally will have a permanent establishment in the United States as a result of the activities of the partnership, assuming that the activities of the partnership rise to the level of a permanent establishment. Rev. Rul. 91-32, 1991-1 C.B. 107. Further, under paragraph 2, the United States generally may tax a partner's distributive share of income realized by a partnership on the disposition of movable property forming part of the business property of the partnership in the United States.

### *Paragraph 3*

Paragraph provides that gains derived by an enterprise of a Contracting State from the alienation of ships, aircraft or containers operated in international traffic shall be taxable only in that Contracting State. Consistent with the definition of containers provided in paragraph 3 of Article 8, containers include trailers, barges, and related equipment for the transport of containers.



Paragraph 3 also provides that those gains that are included within the definition of royalties in paragraph 3 of Article 12 (Royalties) will be subject to the rules of that Article, and not Article 13. The gains referred to are those derived from the alienation of any right or property that gives rise to royalties that are contingent on the productivity, use, or further alienation thereof. The source country may tax such gains at a rate not exceeding 10 percent, in accordance with Article 12.

#### *Paragraph 4*

Paragraph 4 grants to the State of residence of the alienator the exclusive right to tax gains from the alienation of property other than property referred to in paragraphs 1 through 3. For example, gain derived from shares, other than shares described in paragraphs 1 or 2, debt instruments and various financial instruments, may be taxed only in the State of residence of the alienator, to the extent such income is not otherwise characterized as income taxable under another article (e.g., Article 10 (Dividends) or Article 11 (Interest)). Similarly gain derived from the alienation of tangible personal property, other than tangible personal property described in paragraph 3, may be taxed only in the State of residence of the alienator. Sales by a resident of a Contracting State of real property located in a third state are not taxable in the other Contracting State, even if the sale is attributable to a permanent establishment located in the other Contracting State.

#### *Relation to Other Articles*

Notwithstanding the foregoing limitations on taxation of certain gains by the State of source, the saving clause of paragraph 2 of Article 1 (Personal Scope) permits the United States to tax its citizens and residents as if the Convention had not come into effect. Thus, any limitation in this Article on the right of the United States to tax gains does not apply to gains of a U.S. citizens or resident. The benefits of this Article are also subject to the provisions of Article 17 (Limitation on Benefits). Thus, only a resident of a Contracting State that satisfies one of the conditions in Article 17 is entitled to the benefits of this Article.

### **ARTICLE 14 (BRANCH TAX)**

Article 14 permits the United States to impose its branch profits tax and its branch level interest tax on a Bangladesh corporation. Bangladesh may impose a branch profits tax on a U.S. corporation.

#### *Paragraph 1*

Paragraph 1 provides that each Contracting State may impose tax on a company resident in the other State in addition to other taxes permitted by the Convention. The taxes referred to in this paragraph are specified in paragraph 2.

## *Paragraph 2*

Subparagraph (a) of paragraph 2 identifies the taxes referred to in paragraph 1 that may be imposed by the United States and describes the base on which these taxes may be imposed. The rates of these taxes are specified in paragraph 3. Paragraph 2(a) permits the United States to impose its branch profits tax on the “dividend equivalent amount” of a company resident in Bangladesh. The base of the tax is limited to the company's (i) business profits that are attributable to a permanent establishment in the United States (ii) 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 that is otherwise taxed on a net basis as effectively connected income and (iii) gain from the disposition of a United States Real Property Interest, other than an interest in a United States Real Property Holding Corporation. The United States may not impose its branch profits tax on the business profits of a Bangladesh corporation that are effectively connected with a U.S. trade or business but that are not attributable to a permanent establishment and are not otherwise subject to U.S. taxation under Article 6 (Income from Immovable Property) or paragraph 1 of Article 13 (Capital Gains).

The term “dividend equivalent amount” has the same meaning that it has under section 884 of the Code, as amended from time to time, provided the amendments are consistent with the purpose of the branch profits tax. Generally, the dividend equivalent amount for a particular year is the income described above that is included in the corporation's effectively connected earnings and profits for that year, after payment of the corporate tax under Articles 6, 7 or 13, reduced for any increase in the branch's U.S. net equity during the year and increased for any reduction in its U.S. net equity during the year. U.S. net equity is U.S. assets less U.S. liabilities. See, Treas. Reg. section 1.884-1. The dividend equivalent amount for any year approximates the dividend that a U.S. branch office would have paid during the year if the branch had been operated as a separate U.S. subsidiary company.

Paragraph 2(a) also permits the United States to impose its branch level interest tax on a corporation resident in Bangladesh to the extent of the corporation's “excess interest.” In general, excess interest is the portion of the entire enterprise's interest expense that is allocated to the branch over the amount of interest paid by the U.S. branch. The tax is applied to that amount. Such excess interest is deemed to arise in a Contracting State in which that branch is located. The formula for calculating excess interest does not require that interest be fully deductible in one year. Rather, interest may be “excess interest” even though not deductible in a particular year if it is allocable to the U.S. income under U.S. domestic law rules.

Subparagraph (b) of paragraph 2 describes the tax that may be imposed by Bangladesh under this Article. This tax is analogous to the U.S. branch profits tax. Bangladesh may impose its branch tax on the branch of a U.S. company in Bangladesh, or on a U.S. company the income of which is taxed on a net basis in Bangladesh even without a branch there. The amount of income subject to tax is the amount similar to what would be subject to tax if the Bangladesh branch was a subsidiary of the U.S. company, i.e., the dividends the subsidiary would have been likely to have paid to its

U.S. parent. Bangladesh does not now have authority under its law to impose the branch tax described in subparagraph 2(b). Bangladesh currently does not have a branch tax, but does impose a tax on actual remittances.

### *Paragraph 3*

Paragraph 3 specifies the rates at which the taxes described in paragraph 2 may be imposed. The branch profits tax, described in subparagraph 2(a)(i) for the United States, and subparagraph 2(b) for Bangladesh, may be imposed at a rate not exceeding 10 percent, the rate specified in subparagraph 2(a) of Article 10 (Dividends). The branch level interest tax, described in subparagraph 2(a)(ii), may be imposed by the United States at one of the rates specified in paragraphs 2 or 3 of Article 11 (Interest). The standard rate is 10 percent, the rate generally applicable under paragraph 2 of Article 11 to interest payments from U.S. sources to residents of Bangladesh. However, if the permanent establishment in Bangladesh is a branch of a U.S. financial institution, including an insurance company, the rate of tax is limited to 5 percent, the rate applicable under paragraph 3 of article 11 to interest beneficially owned by financial institutions.

## **ARTICLE 15 (INDEPENDENT PERSONAL SERVICES)**

The Convention deals in separate articles with different classes of income from personal services. Article 15 deals with the general class of income from independent personal services and Article 16 deals with the general class of income from dependent personal services. Articles 18 through 21 provide exceptions and additions to these general rules for performance income of entertainers and athletes (Article 18); pensions in respect of personal service income, social security benefits, annuities, alimony, and child support payments (Article 19); government service salaries and pensions (Article 20); and certain income of teachers, students and trainees (Article 21).

Article 15 provides the general rule that an individual who is a resident of a Contracting State and who derives income from the performing of personal services in an independent capacity will be taxable on that income only in his State of residence. The income, however, may be taxed in the other Contracting State if the services are performed there and the income is attributable to a fixed base that is regularly available to the individual in that other State for the purpose of performing his services.

There is an additional rule in Article 15, which is not in the U.S. or OECD Models, but is in the U.N. Model. Under this provision, if an individual who is a resident of one Contracting State is present in the other Contracting State for a period or periods aggregating more than 183 days in a 12-month period beginning or ending in the income year or taxable year concerned, that individual may be taxed in that other State on income from services performed there.

The 183-day period in this Article is to be measured using the “days of physical presence” method. Under this method, the days that are counted include any day in which a part of the day is spent in the host country. (Rev. Rul. 56-24, 1956-1 C.B. 851.) Thus,

days that are counted include the days of arrival and departure; weekends and holidays on which the person does not work but is present within the country; vacation days spent in the country before, during or after the employment period, unless the individual's presence before or after the employment can be shown to be independent of his presence there for employment purposes; and time during periods of sickness, training periods, strikes, etc., when the individual is present but not working. If illness prevented the individual from leaving the country in sufficient time to qualify for the benefit, those days will not count. Also, any part of a day spent in the host country while in transit between two points outside the host country is not counted. These rules are consistent with the description of the 183-day period in paragraph 5 of the Commentary to Article 15 in the OECD Model.

Income derived by persons other than individuals or groups of individuals from the performance of independent personal services is not covered by Article 15. Such income generally would be business profits taxable in accordance with Article 7 (Business Profits). Income derived by employees of such persons generally would be taxable in accordance with Article 16 (Dependent Personal Services).

The term "fixed base" is not defined in the Convention, but its meaning is understood to be similar, but not identical, to that of the term "permanent establishment," as defined in Article 5 (Permanent Establishment). The term "regularly available" also is not defined in the Convention. Whether a fixed base is regularly available to a person will be determined based on all the facts and circumstances. In general, the term encompasses situations where a fixed base is at the disposal of the individual whenever he performs services in that State. It is not necessary that the individual regularly use the fixed base, only that the fixed base be regularly available to him.

The term "personal services in an independent capacity" is not defined. It clearly includes those activities listed in paragraph 2 of Article 14 of the OECD Model, such as independent scientific, literary, artistic, educational or teaching activities, as well as the independent activities of physicians, lawyers, engineers, architects, dentists, and accountants. That list, however, is not exhaustive. The term includes all personal services performed by an individual for his own account, whether as a sole proprietor or a partner, where he receives the income and bears the risk of loss arising from the services.

The taxation of income of an individual from those types of independent services which are covered by Articles 18 through 21 is governed by the provisions of those Articles. For example, taxation of the income of an employee of one of the Contracting States would be governed by Article 20 (Government Service) rather than Article 15.

Paragraph 8 of Article 7 (Business Profits) refers to Article 15. That rule clarifies that income that is attributable to a permanent establishment or a fixed base, but that is deferred and received after the permanent establishment or fixed base no longer exists, may nevertheless be taxed by the State in which the permanent establishment or fixed base was located. Thus, under Article 15, income derived by an individual U.S. resident

from services performed in Bangladesh and attributable to a fixed base there may be taxed by Bangladesh even if the income is deferred and received after there is no longer a fixed base available to the resident in Bangladesh.

This Article is understood to incorporate the principles of paragraph 3 of Article 7 (Business Profits) into Article 15, although, unlike the U.S. Model, it is not made explicit in this Convention. Thus, all relevant expenses must be allowed as deductions in computing the net income from services subject to tax in the Contracting State where the fixed base is located.

#### *Relation to Other Articles*

If an individual resident of Bangladesh who is also a U.S. citizen performs independent personal services in the United States, the United States may, by virtue of the saving clause of paragraph 2 of Article 1 (Personal Scope), tax his income without regard to the restrictions of this Article subject to the special foreign tax credit rules of paragraph 3 of Article 23 (Relief from Double Taxation).

### **ARTICLE 16 (DEPENDENT PERSONAL SERVICES)**

Article 16 apportions taxing jurisdiction between the States of source and residence over remuneration derived by a resident of a Contracting State as an employee.

#### *Paragraph 1*

The general rule of Article 16 is contained in paragraph 1. Remuneration derived by a resident of a Contracting State as an employee may be taxed by the State of residence, and the remuneration also may be taxed by that other Contracting State to the extent derived from employment exercised (i.e., services performed) in the other Contracting State. Paragraph 1 also provides that the more specific rules of Articles 18 (Entertainers and Athletes), 19 (Pensions, Et Cetera), 20 (Government Service), and 21 (Teachers, Students and Trainees) apply in the case of employment income described in one of these articles. Thus, even though the State of source has a right to tax employment income under Article 15, it may not have the right to tax that income under the Convention if the income is described, e.g., in Article 18 (Pensions, Et Cetera) and is not taxable in the State of source under the provisions of that article.

Article 16 applies to “salaries, wages and other remuneration”. Article 16, therefore, applies to any form of compensation for employment, including payments in kind, regardless of whether the remuneration is “similar” to salaries and wages. This position on in-kind payments was confirmed by the addition of paragraph 2.1 to the Commentary to Article 15 of the OECD Model in 1997.

Consistently with section 864(c)(6), Article 16 also applies regardless of the timing of actual payment for services. Thus, a bonus paid to a resident of the United States with

respect to services performed in Bangladesh with respect to a particular taxable year would be subject to Article 16 for that year even if it was paid after the close of the year. Similarly, an annuity received for services performed in a taxable year would be subject to Article 16 despite the fact that it was paid in subsequent years. In either case, whether such payments were taxable in the State where the employment was exercised would depend on whether the tests of paragraph 2 were satisfied. Consequently, a person who receives the right to a future payment in consideration for services rendered in a Contracting State would be taxable in that State even if the payment is received at a time when the recipient is a resident of the other Contracting State.

### *Paragraph 2*

Paragraph 2 sets forth an exception to the general rule that employment income may be taxed in the State where the employment is exercised. Under paragraph 2, the State where the employment is exercised may not tax the income from the employment if three conditions are satisfied: (a) the individual is present in the other Contracting State for a period or periods not exceeding 183 days in any 12-month period that begins or ends during the relevant income year or calendar year; (b) the remuneration is paid by, or on behalf of, an employer who is not a resident of that other Contracting State; and (c) the remuneration is not borne as a deductible expense by a permanent establishment or fixed base that the employer has in that other State. In order for the remuneration to be exempt from tax in the source State, all three conditions must be satisfied. This exception is identical to that set forth in the OECD Model.

The 183-day period in condition (a) is to be measured using the “days of physical presence” method. Under this method, the days that are counted include any day in which a part of the day is spent in the host country (Rev. Rul. 56-24, 1956-1 C.B.) that, are counted include the days of arrival and departure weekends-and holidays on which the employee does not work but is present within the country; vacation days spent in the country before, during or after the employment period, unless the individual's presence before or after the employment can be shown to be independent of his presence there for employment purposes; and time during periods of sickness, training periods, strikes, etc., when the individual is present but not working. If illness prevented the individual from leaving the country in sufficient time to qualify for the benefit, those days will not count. Also, any part of a day spent in the host country while in transit between two points outside the host country is not counted. These rules are consistent with the description of the 183-day period in paragraph 5 of the Commentary to Article 15 in the OECD Model.

Conditions (b) and (c) are intended to ensure that a Contracting State will not be required to allow a deduction to the payor for compensation paid and at the same time to exempt the employee on the amount received. Accordingly, if a foreign person pays the salary of an employee who is employed in the host State, but a host State corporation or permanent establishment reimburses the payer with a payment that can be identified as a reimbursement, neither condition (b) nor (c), as the case may be, will be considered to have been fulfilled.

The reference to remuneration “borne by” a permanent establishment or fixed base is understood to encompass all expenses that economically are incurred and not merely expenses that are currently deductible for tax purposes. Accordingly, the expenses referred to include expenses that are capitalizable as well as those that are currently deductible. Further, salaries paid by residents that are exempt from income taxation may be considered to be borne by a permanent establishment or fixed base notwithstanding the fact that the expenses will be neither deductible nor capitalizable since the payor is exempt from tax.

### *Paragraph 3*

Paragraph 3 contains a special rule applicable to remuneration for services performed by an individual resident of one Contracting State as an employee aboard a ship or aircraft operated in international traffic by an enterprise of a Contracting State. Under this paragraph, the employment income of such persons may be taxed only in the State of residence of the enterprise operating the ship or aircraft if the services are performed as a member of the regular complement of the ship or aircraft. The regular complement includes the crew in the case of a cruise ship, for example, it may also include others, such as entertainers, lecturers, etc., employed by the shipping company to serve on the ship throughout its voyage. The use of the term “regular complement” is intended to clarify that a person who exercises his employment as, for example, an insurance salesman while aboard a ship or aircraft is not covered by this paragraph. This paragraph is inapplicable to persons dealt with in Article 15 (Independent Personal Services).

This provision is based on the OECD Model. U.S. internal law does not impose tax on non-U.S. source income of a person who is neither a U.S. citizen nor a U.S. resident, even if that person is an employee of a U.S. resident enterprise. Thus, the United States may not tax the salary of a resident of Bangladesh who is employed by a U.S. carrier, except as provided in paragraph 2.

### *Paragraph 4*

Paragraph 4 deals, in certain circumstances, with the taxation of an individual who is a resident of one Contracting State and is a director of a company that is resident in the other State. This paragraph applies only if the director is also a shareholder of the company. The paragraph provides that when directors’ fees paid to an individual meeting the above description, exceed the amount that would be paid to a director who is not a shareholder in the company, the excess amount may be taxed by the State of residence of the company, but the rate of tax may not exceed 15 percent of that amount. The excess amount considered analogous to a dividend, and is, therefore, subject to tax at the same rate as portfolio dividends under Article 10 (Dividends).

The Convention, unlike the U.S. and OECD Models, does not have a separate rule for the taxation of director's fees, other than those dealt with in paragraph 4. Other director’s fees, therefore, are subject to the rules of Article 15 (Independent Personal

Services), for outside directors, and paragraphs 1 and 2 of this Article, for inside directors.

#### *Relation to Other Articles*

If a U.S. citizen who is resident in Bangladesh performs service as an employee in the United States and meets the conditions of paragraphs 2, 3 or 4 for source country exemption or reduced rate of tax, the individual nevertheless is taxable in the United States by virtue of the saving clause of paragraph 2 of Article 1 (Personal Scope), subject to the special foreign tax credit rule of paragraph 3 of Article 23 (Relief from Double Taxation).

### **ARTICLE 17 (LIMITATION ON BENEFITS)**

#### *Structure of the Article*

Article 17 follows the general form used in other recent U.S. income tax treaties. The structure of the Article is as follows: Paragraph 1 states the general rule that residents of a Contracting State are entitled to benefits otherwise accorded to residents only if the resident satisfies one or more of the attributes of a resident specified in the paragraph. A person that satisfies one or more of the attributes will be entitled to all the benefits of the Convention. Paragraph 2 provides that, with respect to a person not entitled to benefits under paragraph 1, benefits nonetheless may be granted to that person with regard to certain types of income. Paragraph 3 provides that benefits also may be granted if the competent authority of the State from which benefits are claimed determines that it is appropriate to provide benefits in that case. Paragraph 4 defines the term “recognized stock exchange” as used in paragraph 1(d). Paragraph 5 provides that the competent authorities may consult to develop procedures for the application of the Article and may exchange information to carry out the provisions of the Article.

#### *Paragraph 1*

Paragraph 1 provides that a resident of a Contracting State will be entitled to the all of the benefits otherwise accorded to residents of a Contracting State under the Convention only to the extent provided in the paragraph. The benefits to which residents of a Contracting State are entitled under the Convention include all limitations on source-based taxation under Articles 6 through 22, the treaty-based relief from double taxation provided by Article 23 (Relief from Double Taxation), and the protection afforded to residents of a Contracting State under Article 24 (Nondiscrimination). Some provisions do not require that a person be a resident in order to enjoy the benefits of those provisions. These include paragraph 1 of Article 24, Article 25 (Mutual Agreement Procedure), and Article 27 (Effect of Convention on Diplomatic Agents and Consular Officers, Domestic Laws, and Other Treaties). Article 17 accordingly does not limit the availability of the benefits of these provisions.



It is intended that the provisions of paragraph 1 will be self executing. Claiming benefits under paragraph 1 does not require an advance competent authority ruling or approval. The tax authorities may, of course, on review, determine that the taxpayer has improperly interpreted the paragraph and is not entitled to the benefits claimed.

Article 17 and, the anti-abuse provisions of domestic law complement each other, as Article 17 effectively determines whether an entity has a sufficient nexus to the Contracting State to be treated as a resident for treaty purposes, while domestic anti-abuse provisions (e.g., business purpose, substance-over-form, step transaction or conduit principles) determine whether a particular transaction should be recast in accordance with its substance. Thus, internal law principles of the source State may be applied to identify the beneficial owner of an item of income, and Article 17 then will be applied to the beneficial owner to determine if that person is entitled to the benefits of the Convention with respect to such income.

Paragraph 1 has six subparagraphs, each of which describes a category of residents that are entitled to all benefits of the Convention.

*Individuals - - Subparagraph 1(a)*

Subparagraph a) provides that individual residents of a Contracting State will be entitled to all treaty benefits. If such an individual receives income as a nominee on behalf of a third country resident, benefits may be denied under the respective articles of the Convention by the requirement that the beneficial owner of the income be a resident of a Contracting State.

*Governmental Entities -- Subparagraph 1(b)*

Subparagraph b) provides that a Contracting State, a political subdivision or local authority thereof will be entitled to all benefits of the Convention.

*Ownership/Base Erosion -- Subparagraph 1(c)*

Subparagraph 2(c) provides a two part test, the so-called ownership and base erosion test. This test applies to any form of legal entity that is a resident of a Contracting State. Both prongs of the test must be satisfied for the resident to be entitled to benefits under subparagraph 2(c).

The ownership prong of the test, under clause i), requires that more than 50 percent of the beneficial interests in the person (in the case of a corporation, more than 50 percent of the shares in each class of its shares) be owned, directly or indirectly, by persons who are themselves entitled to benefits under the other tests of paragraph 2 (i.e., subparagraphs a), b), d), e) or f)), or who are U.S. citizens.

A trust may be entitled to benefits under this provision if it is treated as a resident under Article 4 (Fiscal Domicile) and it otherwise satisfies the requirements of this

subparagraph. For purposes of this subparagraph, the beneficial interests in a trust will be considered to be owned by its beneficiaries in proportion to each beneficiary's actuarial interest in the trust. The interest of a remainder beneficiary will be equal to 100 percent less the aggregate percentages held by income beneficiaries. A beneficiary's interest in a trust will not be considered to be owned by a person entitled to benefits under the other provisions of paragraph 2 if it is not possible to determine the beneficiary's actuarial interest. Consequently, if it is not possible to determine the actuarial interest of any beneficiaries in a trust, the ownership test under clause i) cannot be satisfied, unless all beneficiaries are persons entitled to benefits under the other subparagraphs of paragraph 2.

The base erosion prong of the test under clause (ii) of subparagraph 1(c) requires that not more than 50 percent of the person's gross income for the taxable year be paid or accrued, directly or indirectly, to persons who are not citizens of the United States and are not entitled to benefits under the other subparagraphs of this paragraph, in the form of payments, including interest and royalties, that are deductible for tax purposes in the person's State of residence. To the extent they are deductible from the taxable base, trust distributions are considered deductible payments. Depreciation and amortization deductions, which are not "payments," are disregarded for this purpose.

The term "gross income" is not defined in the Convention. Thus, in accordance with paragraph 2 of Article 3 (General Definitions), in determining whether a person deriving income from United States sources is entitled to the benefits of the Convention, the United States will ascribe the meaning to the term that it has in the United States. In such cases, "gross income" will be defined as gross receipts less cost of goods sold.

#### *Publicly-Traded Corporations -- Subparagraph 1(d)*

Subparagraph d) applies to publicly-traded corporations, and provides that a company will be entitled to all the benefits of the Convention if in the principal class of shares of the company there is substantial and regular trading on a recognized "stock exchange" located in either Contracting State. The term "recognized stock exchange" is defined in paragraph 4.

The term "principal class of shares" is not defined in the Convention, but will be interpreted by the United States, consistently with other recent U.S. tax treaties and the U.S. Model to mean that class of shares that represents the majority of the voting power and value of the company. In most cases, this class will be the ordinary or common shares of the company. If the company has more than one class of shares, it is necessary as an initial matter to determine whether one of the classes accounts for more than half of the voting power and value of the company. If so, then only those shares are considered for purposes of the regular trading requirement. If no single class of shares accounts for more than half of the company's voting power and value, it is necessary to identify a group of two or more classes of the company's voting power and value, and then to determine whether each class of shares in this group satisfy the regular trading requirement. Although in a particular case involving a company with several classes of

shares it is conceivable that more than one group of classes could be identified that account for more than 50 percent of the shares, it is only necessary for one such group to satisfy the requirements of this subparagraph in order for the company to be entitled to benefits. Benefits would not be denied to the company even if a second, non-qualifying, group of shares with more than half of the company's voting power and value could be identified.

The term “substantial and regular trading” is not defined in the Convention. In accordance with paragraph 2 of Article 3 (General Definitions), this term will be defined by reference to the domestic tax laws of the State from which treaty benefits are sought, generally the source State. In the case of the United States, this term is understood to have the meaning it has under Treas. Reg. section 884-5 (d)(4)(i)(B), relating to the branch tax provisions of the Code. Under these regulations, a class of shares is considered to be “regularly traded” if two requirements are met: trades in the class of shares are made in more than de minimis quantities on at least 60 days during the taxable year, and the aggregate number of shares in the class traded during the year is at least 10 percent of the average number of shares outstanding during the year. Treasury Reg. sections 1.884-5 (d)(4)(i)(A), (ii) and (iii) will not be taken into account for purposes of defining the term “regularly traded” under the Convention. Authorized but unissued shares are not considered for purposes of this test.

As described more fully below, the regular trading requirement can be met by trading on any recognized exchange. Trading on one or more recognized securities exchanges may be aggregated for purposes of this requirement. Thus, a U.S. company could satisfy the regularly traded requirement through trading, in whole or in part, on a recognized securities exchange located in Bangladesh.

#### *Subsidiaries of Publicly-Traded Corporations -- Subparagraph 1(e)*

Subparagraph 1(e) provides a test under which certain companies that are directly or indirectly controlled by companies satisfying the publicly-traded test of subparagraph 1(d) may be entitled to the benefits of the Convention. Under this test, a company will be entitled to the benefits of the Convention if 50 percent or more of each class of shares in the company is directly or indirectly owned by five or fewer companies that are described in subparagraph 1(d). This test differs from that under subparagraph 1(d) in that 50 percent of each class of the company's shares, not merely the class or classes accounting for more than 50 percent of the company's votes and value, must be held by publicly-traded companies described in subparagraph 1(d). Thus, the test under subparagraph 1(e) considers the ownership of every class of shares outstanding, while the test under subparagraph 1(d) considers only the company's principal class of shares. The ownership by publicly-traded companies described in subparagraph 1(d) may be indirect. However, any intermediate owners in the chain of ownership must themselves be entitled to benefits under paragraph 1.

*Tax exempt organizations -- Subparagraph 1(f)*

Subparagraph 1(f) provides that the tax exempt organizations described in subparagraph 1(c) of Article 4 (Fiscal Domicile) will be entitled to all the benefits of the Convention. Those entities described in clause (ii) of subparagraph 1(c) of Article 4 (i.e., pension funds) however, will be entitled to benefits only if more than half of the beneficiaries, members or participants of the organization are entitled to the benefits of the Convention under this Article. For purposes of this provision, the term “beneficiaries” should be understood to refer to the persons receiving benefits from the organization.

*Paragraph 2*

Paragraph 2 sets forth a test under which a resident of a Contracting State that is not generally entitled to benefits of the Convention under paragraph 1 may receive treaty benefits with respect to certain items of income that are connected to an active trade or business conducted in its State of residence.

Subparagraph 2(a) sets forth the general rule that a resident of a Contracting State engaged in the active conduct of a trade or business in that State may obtain the benefits of the Convention with respect to a particular item of income.

The term “trade or business” is not defined in the Convention. Pursuant to paragraph 2 of Article 3 (General Definitions), when determining whether a resident of the other State is entitled to the benefits of the Convention under paragraph 2 with respect to income derived from U.S. sources, the United States will ascribe to this term the meaning that it has under the law of the United States. Accordingly, the United States competent authority will refer to the regulations issued under section 367(a) for the definition of the term “trade or business.” In general, therefore, a trade or business will be considered to be a specific unified group of activities that constitute or could constitute an independent economic enterprise carried on for profit. Furthermore, a corporation generally will be considered to carry on a trade or business only if the officers and employees of the corporation conduct substantial managerial and operational activities. See, Code section 367(a)(3) and the regulations thereunder.

Notwithstanding this general definition of trade or business, subparagraph 2(a) provides that the business of making or managing investments for the resident’s own account will be considered to be a trade or business only when part of a banking, insurance or securities activities conducted by a bank, insurance company, or registered securities dealer. Such activities conducted by a person other than a bank, insurance company or registered securities dealer will not be considered to be the conduct of an active trade or business, nor would they be considered to be the conduct of an active trade or business if conducted by a banking or insurance company but not as part of the company's banking or insurance business.

Because a headquarters operation is in the business of managing investments, a company that functions solely as a headquarters company will not be considered to be engaged in an active trade or business for purposes of paragraph 2.

Subparagraph 2(a) also provides that an item of income that is derived in connection with, or is incidental to, a trade or business will be entitled to benefits under paragraph 2. Paragraph 2(c) elaborates on the meaning of the terms “in connection with” and “incidental to.”

An item of income will be considered to be earned in connection with a trade or business if the income-producing activity in the other State is a line of business that forms a part of or is complementary to the trade or business conducted in the State of residence by the income recipient.

Although no definition of the terms “forms a part of” or “complementary” is set forth in the Convention, it is intended that a business activity generally will be considered to “form a part of” a business activity conducted in the other State if the two activities involve the design, manufacture or sale of the same products or type of products, or the provision of similar services. The line of business in the State of residence may be upstream, downstream, or parallel to the activity conducted in the State of source. Thus, the line of business may provide inputs for a manufacturing process that occurs in the State of source, may sell the output of that manufacturing process, or simply may sell the same sorts of products that are being sold by the trade or business carried on in the State of source. In order for two activities to be considered to be “complementary,” the activities need not relate to the same types of products or services, but they should be part of the same overall industry and be related in the sense that the success or failure of one activity will tend to result in success or failure for the other. In cases in which more than one trade or business is conducted in the other State and only one of the trades or businesses forms a part of or is complementary to a trade or business conducted in the State of residence, it is necessary to identify the trade or business to which an item of income is attributable. Royalties generally will be considered to be derived in connection with the trade or business to which the underlying intangible property is attributable. Dividends will be deemed to be derived first out of earnings and profits of the treaty-benefited trade or business, and then out of other earnings and profits. Interest income may be allocated under any reasonable method consistently applied. A method that conforms to U.S. principles for expense allocation will be considered a reasonable method. The following examples illustrate the application of This principle.

Example 1. USCo is a corporation resident in the United States. USCo is engaged in an active manufacturing business in the United States. USCo owns 100 percent of the shares of BCo, a corporation resident in Bangladesh. BCo distributes USCo products in Bangladesh. Since the business activities conducted by the two corporations involve the same products, BCo's distribution business is considered to form a part of USCo's manufacturing business within the meaning of subparagraph 2(c).

Example 2. The facts are the same as in Example 1, except that USCo does not manufacture. Rather, USCo operates a large research and development facility in the

United States that licenses intellectual property to affiliates worldwide, including BCo. BCo and other USCo affiliates then manufacture and market the USCo-designed products in their respective markets. Since the activities conducted by BCo and USCo involve the same product lines, these activities are considered to form a part of the same trade or business.

Example 3. Americair is a corporation resident in the United States that operates an international airline. BSub is a wholly-owned subsidiary of Americair resident in Bangladesh. BSub operates a chain of hotels in Bangladesh that are located near airports served by Americair flights. Americair frequently sells tour packages that include air travel to Bangladesh and lodging at BSub hotels. Although both companies are engaged in the active conduct of a trade or business, the businesses of operating a chain of hotels and operating an airline are distinct trades or businesses. Therefore BSub's business does not form a part of Americair's business. However, BSub's business is considered to be complementary to Americair's business because they are part of the same overall industry (travel) and the links between their operations tend to make them interdependent.

Example 4. The facts are the same as in Example 3, except that BSub owns an office building in Bangladesh instead of a hotel chain. No part of Americair's business is conducted through the office building. BSub's business is not considered to form a part of or to be complementary to Americair's business. They are engaged in distinct trades or businesses in separate industries, and there is no economic dependence between the two operations.

Example 5. USFlower is a corporation resident in the United States. USFlower produces and sells flowers in the United States and other countries. USFlower owns all the shares of B Holding, a corporation resident in Bangladesh. B Holding is a holding company that is not engaged in a trade or business. B Holding owns all the shares of three corporations that are resident in the other Contracting State: BFlower, BLawn, and BFish. BFlower distributes USFlower flowers under the USFlower trademark in Bangladesh. BLawn markets a line of lawn care products in Bangladesh under the USFlower trademark. In addition to being sold under the same trademark, BLawn and BFlower products are sold in the same stores and sales of each company's products tend to generate increased sales of the other's products. BFish imports fish from the United States and distributes it to fish wholesalers in Bangladesh. For purposes of paragraph 2, the business of BFlower forms a part of the business of USFlower, the business of BLawn is complementary to the business of USFlower, and the business of BFish is neither part of nor complementary to that of USFlower.

Finally, a resident in one of the States also will be entitled to the benefits of the Convention with respect to income derived from the other State if the income is “incidental” to the trade or business conducted in the recipient's State of residence. Subparagraph 2(c) provides that income derived from a State will be incidental to a trade or business conducted in the other State if the production of such income facilitates the conduct of the trade or business in the other State. An example of incidental income is the temporary investment of working capital derived from a trade or business.

Subparagraph 2 (b) provides an additional constraint on the allowance of benefits under paragraph 2. That subparagraph provides that if the enterprise deriving the income, or any of its associated enterprises, has an ownership interest in the income producing activity in the other State, an item of income that the resident of the first-mentioned State derives from the other State will be entitled to the benefits of the Convention under paragraph 2 only if the first-mentioned trade or business is “substantial” in relation to the income-producing activity in the other State. Subparagraph 2(b) provides that whether the trade or business of the income recipient is substantial will be determined based on all the facts and circumstances. These circumstances generally would include the relative scale of the activities conducted in the two States and the relative contributions made to the conduct of the trade or businesses in the two States.

The substantiality requirement is intended to prevent a narrow case of treaty-shopping abuses in which a company attempts to qualify for benefits by engaging in de minimis connected business activities in the treaty country in which it is resident, i.e., activities that have little economic cost or effect with respect to the company business as a whole. The application of the substantiality test only to income from related parties focuses only on potential abuse cases, and does not hamper certain other kinds of non-abusive activities, even though the income recipient resident in a Contracting State may be very small in relation to the entity generating income in the other Contracting State. For example, if a small U.S. research firm develops a process that it licenses to a very large, unrelated, Bangladesh pharmaceutical manufacturer, the size of the U.S. research firm would not have to be tested against the size of the Bangladesh manufacturer. Similarly, a small U.S. bank that makes a loan to a very large unrelated Bangladesh business would not have to pass a substantiality test to receive treaty benefits under subparagraph (b).

### *Paragraph 3*

Paragraph 3 provides that a resident of one of the States that is not otherwise entitled to the benefits of the Convention may be granted benefits under the Convention if the competent authority of the State in which the income arises so determines. This discretionary provision is included in recognition of the fact that, with the increasing scope and diversity of international economic relations, there may be cases where significant participation by third country residents in an enterprise of a Contracting State is warranted by sound business practice or long-standing business structures and does not necessarily indicate a motive of attempting to derive unintended Convention benefits.

The competent authority of a State will base a determination under this paragraph on whether the establishment, acquisition, or maintenance of the person seeking benefits under the Convention, or the conduct of such person's operations, has or had as one of its principal purposes the obtaining of benefits under the Convention. Thus, persons that establish operations in one of the States with the principal purpose of obtaining the benefits of the Convention ordinarily will not be granted relief under paragraph 3.

The competent authority may determine to grant all benefits of the Convention, or it may determine to grant only certain benefits. For instance, it may determine to grant benefits only with respect to a particular item of income in a manner similar to paragraph 2. Further, the competent authority may set time limits on the duration of any relief granted.

It is assumed that, for purposes of implementing paragraph 3, a taxpayer will not be required to wait until the tax authorities of one of the States have determined that benefits are denied before he will be permitted to seek a determination under this paragraph. In these circumstances, it is also expected that if the competent authority determines that benefits are to be allowed, they will be allowed retroactively to the time of entry into force of the relevant treaty provision or the establishment of the structure in question, whichever is later.

#### *Paragraph 4*

Paragraph 4 provides that the term “recognized stock exchange” means (i) the NASDAQ System owned by the National Association of Securities Dealers, and any stock exchange registered with the Securities and Exchange Commission as a national securities exchange for purposes of the Securities Exchange Act of 1934; and (ii) the stock exchanges regulated by the Bangladesh Securities and Exchange Commission. The term “recognized stock exchange” may also be expanded to include other exchanges, either in the Contracting States or in third states, which may be agreed upon by the competent authorities of the two States

#### *Paragraph 5*

Paragraph 5 provides additional authority to the competent authorities (in addition to that of Article 25 (Mutual Agreement Procedure)) to consult together to develop a common application of the provisions of this Article, including the publication of guidance. The competent authorities shall, in accordance with the provisions of Article 26 (Exchange of Information and Administrative Assistance) exchange such information as is necessary to carry out the provisions of the Article.

### **ARTICLE 18 (ENTERTAINERS AND ATHLETES)**

This Article deals with the taxation in a Contracting State of entertainers and athletes resident in the other Contracting State from the performance of their services as such. The Article applies both to the income of an entertainer or athlete who performs services on his own behalf and one who performs services on behalf of another person, either as an employee of that person, or pursuant to any other arrangement. The rules of this Article take precedence, in some circumstances, over those of Articles 15 (Independent Personal Services) and 16 (Dependent Personal Services).

This Article applies only with respect to the income of performing entertainers and athletes. Others involved in a performance or athletic event, such as producers,



directors, technicians, managers, coaches, etc., remain subject to the provisions of Articles 15 (Independent Personal Services) and 16 (Dependent Personal Services). In addition, except as provided in paragraph 2, income earned by legal persons is not covered by Article 18.

### *Paragraph 1*

Paragraph 1 describes the circumstances in which a Contracting State may tax the performance income of an entertainer or athlete who is a resident of the other Contracting State. Under the paragraph, income derived by an individual resident of a Contracting State from activities as an entertainer or athlete exercised in the other Contracting State may be taxed in that other State if the amount of the gross receipts derived by the performer exceeds \$10,000 (or its equivalent in Bangladesh taka) for the taxable year. The \$10,000 includes expenses reimbursed to the individual or borne on his behalf. If the gross receipts exceed \$10,000, the full amount, not just the excess, may be taxed in the State of performance.

The OECD Model provides for taxation by the country of performance of the remuneration of entertainers or athletes with no dollar or time threshold. The United States introduces the dollar threshold test in its treaties to distinguish between two groups of entertainers and athletes those who are paid very large sums of money for very short periods of service, and who would, therefore, normally be exempt from host country tax under the standard personal services income rules, and those who earn relatively modest amounts and are, therefore, not easily distinguishable from those who earn other types of personal service income. The United States has entered a reservation to the OECD Model on this point.

Tax may be imposed under paragraph 1 even if the performer would have been exempt from tax under Articles 15 (Independent Personal Services) or 16 (Dependent Personal Services). However, if the performer would be exempt from host country tax under Article 18, but would be taxable under either Article 15 or 16, Article 18 will not apply to exempt the performer from host country tax. Thus, for example, if a performer derives remuneration from his activities in an independent capacity, and the remuneration is not attributable to a fixed base, he may be taxed by the host State in accordance with Article 18 if his remuneration exceeds \$10,000 annually, despite the fact that he generally would be exempt from host State taxation under Article 15. Also, a performer who receives less than the \$10,000 threshold amount and therefore is not taxable under Article 18, nevertheless may be subject to tax in the host country under Articles 15 or 16 if the tests for host-country taxability under those Articles are met.

Since it frequently is not possible to know until year-end whether the income an entertainer or athlete derived from a performance in a Contracting State will exceed \$10,000, nothing in the Convention precludes that Contracting State from withholding tax during the year and refunding the money after the close of the taxable year.

As explained in paragraph 9 of the OECD Commentary to Article 17, Article 18 applies to all income connected with a performance by the entertainer, such as appearance fees, award or prize money, and a share of the gate receipts. Income derived from a Contracting State by a performer who is a resident of the other Contracting State from other than actual performance, such as royalties from record sales and payments for product endorsements, is not covered by this Article, but by other articles of the Convention, such as Article 12 (Royalties) or Article 15 (Independent Personal Services). For example, if an entertainer receives royalty income from the sale of live recordings, the royalty income would be subject to source country tax of no more than 10 percent of the gross amount of the royalty under Article 12, even if the performance was conducted in the source country, although he could be taxed in the source country with respect to income from the performance itself under this Article if the dollar threshold is exceeded.

In determining whether income falls under Article 18 or another article, the controlling factor will be whether the income in question is predominantly attributable to the performance itself or other activities or property rights. For instance, a fee paid to a performer for endorsement of a performance in which the performer will participate would be considered to be so closely associated with the performance itself that it normally would fall within Article 18. Similarly, a sponsorship fee paid by a business in return for the right to attach its name to the performance would be so closely associated with the performance that it would fall under Article 18 as well. As indicated in paragraph 9 of the Commentary to Article 17 of the OECD Model, a cancellation fee would not be considered to fall within Article 18 but would be dealt with under Article 7, 15 or 16.

As indicated in paragraph 4 of the Commentary to Article 17 of the OECD Model, where an individual fulfills a dual role as performer and non-performer (such as a player-coach or an actor-director), but his role in one of the two capacities is negligible, the predominant character of the individual's activities should control the characterization of those activities. In other cases there should be an apportionment between the performance-related compensation and other compensation.

Consistent with Article 16 (Dependent Personal Services), Article 18 also applies regardless of the timing of actual payment for services. Thus, a bonus paid to a resident of a Contracting State with respect to a performance in the other Contracting State with respect to a particular taxable year would be subject to Article 18 for that year even if it was paid after the close of the year.

Paragraph 1 contains an additional rule, not found in the U.S. Model. It provides an exception to the general rule of paragraph 1 in the case of a visit to a Contracting State by an entertainer or athlete who is a resident of the other Contracting State, if the visit is wholly or mainly supported by the public funds of his State of residence or of a political subdivision or local authority of that State. In the circumstances described, only the Contracting State of residence of the entertainer or athlete may tax his income from the performances so supported in the other State.

## *Paragraph 2*

Paragraph 2 is intended to deal with the potential for abuse when a performer's income does not accrue directly to the performer himself, but to another person. Foreign performers commonly perform in the United States as employees of, or under contract with, a company or other person.

The relationship may truly be one of employee and employer, with no abuse of the tax system either intended or realized on the other hand, the “employer” may, for example, be a company established and owned by the performer, which is merely acting as the nominal income recipient in respect of the remuneration for the performance (a “star company”). The performer may act as an “employee,” receive a modest salary, and arrange to receive the remainder of the income from his performance in another form or at a later time. In such case, absent the provisions of paragraph 2, the income arguably could escape host-country tax because the star company earns business profits but has no permanent establishment in that country. The performer may largely or entirely escape host-country tax by receiving only a small salary in the year the services are performed, perhaps small enough to place him below the dollar threshold in paragraph 1. The performer might arrange to receive further payments in a later year, when he is not subject to host-country tax, perhaps as deferred salary payments, dividends or liquidating distributions.

Paragraph 2 seeks to prevent this type of abuse while at the same time protecting the taxpayer's rights to the benefits of the Convention when there is a legitimate employee-employer relationship between the performer and the person providing his services. Under paragraph 2, when the income accrues to a person other than the performer, and the performer or related persons participate, directly or indirectly, in the receipts or profits of that other person, the income may be taxed in the Contracting State where the performer's services are exercised, without regard to the provisions of the Convention concerning business profits (Article 7) or independent personal services (Article 15). Thus, even if the “employer” has no permanent establishment or fixed base in the host country, its income may be subject to tax there under the provisions of paragraph 2. Taxation under paragraph 2 is on the person providing the services of the performer. This paragraph does not affect the rules of paragraph 1, which apply to the performer himself. The income taxable by virtue of paragraph 2 is reduced to the extent of salary payments to the performer, which fall under paragraph 1.

For purposes of paragraph 2, income is deemed to accrue to another person (i.e., the person providing the services of the performer) if that other person has control over, or the right to receive, gross income in respect of the services of the performer. Direct or indirect participation in the profits of a person may include, but is not limited to, the accrual or receipt of deferred remuneration, bonuses, fees, dividends, partnership income or other income or distributions.

Paragraph 2 does not apply if it is established that neither the performer nor any persons related to the performer participate directly or indirectly in the receipts or profits

of the person providing the services of the performer. Assume, for example, that a circus owned by a U.S. corporation performs in Bangladesh, and promoters of the performance in Bangladesh pay the circus, which, in turn, pays salaries to the circus performers. The circus is determined to have no permanent establishment in Bangladesh. Since the circus performers do not participate in the profits of the circus, but merely receive their salaries out of the circus' gross receipts, the circus is protected by Article 7 (Business Profits) and its income is not subject to Bangladesh tax. Whether the salaries of the circus performers are subject to Bangladesh tax under this Article depends on whether they exceed the \$10,000 threshold in paragraph 1.

This exception from paragraph 2 for non-abusive cases is not found in the OECD Model. The United States has entered a reservation to the OECD Model on this point.

Since pursuant to Article 1 (Personal Scope) the Convention only applies to persons who are residents of one of the Contracting States, if the star company is not a resident of one of the Contracting States then taxation of the income is not affected by Article 18 or any other provision of the Convention.

#### *Relationship to other articles*

This Article is subject to the provisions of the saving clause of paragraph 2 of Article 1 (Personal Scope). Thus, if an entertainer or a sportsman who is resident in Bangladesh is a citizen of the United States, the United States may tax all of his income from performances in the United States without regard to the provisions of this Article, subject, however, to the special foreign tax credit provisions of paragraph 3 of Article 23 (Relief from Double Taxation). In addition, benefits of this Article are subject to the provisions of Article 17 (Limitation on Benefits).

### **ARTICLE 19 (PENSIONS, ET CETERA)**

This Article deals with the taxation of private (i.e., non-government service) pensions and annuities, social security benefits, alimony and child support payments.

#### *Paragraph 1*

Paragraph 1 provides that distributions from pensions and other similar remuneration beneficially owned by a resident of a Contracting State in consideration of past employment are taxable only in the State of residence of the beneficiary. The term “pension distributions and other similar remuneration” includes both periodic and single sum payments.

The phrase “pension distributions and other similar remuneration” is intended to encompass payments made by private retirement plans and arrangements in consideration of past employment. In the United States, the plans encompassed by paragraph 1 include: qualified plans under section 401(a) of the Code, individual retirement plans (including individual retirement plans that are part of a simplified employee pension plan that

satisfies section 408(k), individual retirement accounts, individual retirement annuities, section 408(p) accounts, and IRAs under section 408A), section 403(a) qualified annuity plans, and section 403(b) plans. Distributions from governmental section 457(b) plans may also fall under paragraph 1 if they are not paid with respect to government services covered by Article 20. The Competent Authorities may agree that distributions from other plans that generally meet similar criteria to those applicable to other plans established under their respective laws also qualify for the benefits of Paragraph 1.

Pensions in respect of government service in Article 20 are not covered by this paragraph. They are covered either by paragraph 2 of this Article, if they are in the form of social security benefits, or by paragraph 2 of Article 20 (Government Service). Thus, Article 20 generally covers section 457, 401(a) and 403 (b) plans established for government employees. If a pension in respect of government service is not covered by Article 20 solely because the services were performed in connection with a business, the pension is covered by this Article.

#### *Paragraph 2*

The treatment of social security benefits is dealt with in paragraph 2. This paragraph provides that, notwithstanding the provision of paragraph 1 under which private pensions are taxable exclusively in the State of residence of the beneficial owner, social security and other public pensions paid by one of the Contracting States to a resident of the other Contracting State or to a citizen of the United States will be taxable only in the Contracting State making the payment. This paragraph applies to social security beneficiaries whether they have contributed to the system as private sector or Government employees.

The phrase “and other public pensions” is intended to refer to United States tier 1 Railroad Retirement benefits. The reference to U.S. citizens is necessary to ensure that a social security payment by Bangladesh to a U.S. citizen who is not resident in the United States will not be taxable by the United States.

#### *Paragraph 3*

Under paragraph 3, annuities that are derived and beneficially owned by a resident of a Contracting State are taxable only in that State. An annuity, as the term is used in this paragraph, means a stated sum paid periodically at stated times during life or during a specified number of years, under an obligation to make the payment in return for adequate and full consideration (other than for services rendered). An annuity received in consideration for services rendered would be treated as deferred compensation and generally taxable in accordance with Article 16 (Dependent Personal Services).

#### *Paragraphs 4 and 5*

Paragraphs 4 and 5 deal with alimony and child support payments. Both alimony, under paragraph 4, and child support payments, under paragraph 5, are defined as

periodic payments made pursuant to a written separation agreement or a decree of divorce, separate maintenance, or compulsory support. Paragraph 4, however, deals only with payments of that type that are taxable to the payee. Under that paragraph, alimony (i.e., a payment that is taxable in the hands of the recipient) paid by a resident of a Contracting State to a resident of the other Contracting State is taxable under the Convention only in the State of residence of the recipient. Paragraph 5 deals with those periodic payments that are for the support of a child and that are not covered by paragraph 4 (i.e., those payments that are not taxable to the payee). These types of payments by a resident of a Contracting State to a resident of the other Contracting State are taxable in neither Contracting State.

#### *Relationship to other Articles*

Paragraphs 1, 3 and 4 of Article 19 are subject to the saving clause of paragraph 2 of Article 1 (Personal Scope). Thus, a U.S. citizen who is a resident of Bangladesh, and receives either a pension, annuity or alimony payment from the United States, may be subject to U.S. tax on the payment, notwithstanding the rules in those three paragraphs that give the State of residence of the recipient the exclusive taxing right. Paragraphs 2 and 5 are excepted from the saving clause by virtue of paragraph 3(a) of Article 1. Thus, the United States will allow U.S. citizens and residents the benefits of paragraphs 2 and 5.

### **ARTICLE 20 (GOVERNMENT SERVICE)**

#### *Paragraph 1*

Subparagraphs (a) and (b) of paragraph 1 deal with the taxation of government compensation (other than a pension). Unlike the OECD Model, but like the U.S. Model, the paragraph applies both to government employees and to independent contractors engaged by governments to perform services for them.

Subparagraph (a) provides that remuneration paid by one of the States or its political subdivisions or local authorities to any individual who is rendering services to that State, political subdivision or local authority, is exempt from tax by the other State. Under subparagraph (b), such payments are, however, taxable exclusively in the other State (i.e., the host State) if the services are rendered in that other State and the individual is a resident of that State who is either (i) a national of that State, or (ii) a person who did not become resident of that State solely for purposes of rendering the services.

For example, assume that the U.S. Embassy in Dhaka hires a local resident who became a resident of Bangladesh solely for purposes of rendering services to the Embassy. If that individual is a Bangladesh national, the salary paid to him will be taxable only by Bangladesh. However, if the individual is not a Bangladesh national, the salary will be taxable only by the United States.

### *Paragraph 2*

Paragraph 2 deals with the taxation of a pension paid by, or out of funds created by, one of the States or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority. Subparagraph (a) provides that such a pension is taxable only in that State. Subparagraph (b) provides an exception under which such a pension is taxable only in the other state if the individual is a resident of, and a national of, that other State. Pensions paid to retired civilian and military employees of a Government of either State are intended to be covered under paragraph 2.

When benefits paid by a State in respect of services rendered to that State or a subdivision or authority are in the form of social security benefits, however, those payments are covered by paragraph 2 of Article 19 (Pensions, Et Cetera). As a general matter, the result will be the same whether Article 19 or 20 applies, since social security benefits are taxable exclusively by the source country and so are government pensions. The result will differ only when the payment is made to a citizen and resident of the other Contracting State, who is not also a citizen of the paying State. In such a case, social security benefits continue to be taxable at source while government pensions become taxable only in the residence country.

### *Paragraph 3*

Paragraph 3 provides that if the services are performed in connection with a business carried on by the State or by a subdivision or local authority, then paragraphs 1 and 2 do not apply. In such cases, the ordinary rules apply: Article 15 or 16 for wages, salaries, directors fees and other similar payments, Article 18 for entertainers and athletes, and Article 19 for pensions.

### *Relation to other Articles*

Under paragraph 3(b) of Article 1 (Personal Scope), the saving clause (paragraph 2 of Article 1) does not apply to the benefits conferred by one of the States under Article 20 if the recipient of the benefits is neither a citizen of that State, nor a person who has been admitted for permanent residence there (i.e., in the United States, a “green card” holder). Thus, a resident of a Contracting State who in the course of performing functions of a governmental nature becomes a resident of the other State (but not a permanent resident) would be entitled to the benefits of this Article. However, an individual who receives a pension paid by the Government of Bangladesh in respect of services rendered to Bangladesh shall be taxable on this pension only in Bangladesh unless the individual is a U.S. citizen or acquires a U.S. green card.

## **ARTICLE 21 (TEACHERS, STUDENTS AND TRAINEES)**

### *Paragraph 1*

Paragraph 1 provides a two-year exemption from tax in one Contracting State for an individual who visits that State (the “host State”) for the purpose of teaching or engaging in research at a university, college or other recognized educational institution in that State. This rule applies only if the individual is a resident of the other Contracting State immediately before his visit begins. The exemption applies to any remuneration for such teaching or research. The exemption from tax applies only for two years from the date he first visits the host State for the purpose of teaching or engaging in research at a university, college or other recognized educational institution there.

The host State exemption will apply if the teaching or research is carried on at an accredited university, college, school or other recognized educational institution. An educational institution will be considered to be accredited if it is accredited by an authority that generally is responsible for accreditation of institutions in the particular field of study.

### *Paragraph 2*

This paragraph provides rules for host-country taxation of visiting students, apprentices or business trainees, and persons studying or doing research as the recipient of a grant from a government or a charitable institution. Visitors must be in the host State for the primary purpose of engaging in these activities. Persons who meet the tests of the paragraph will be exempt from tax in the State that they are visiting with respect to designated classes of income.

The visitor must have been, either at the time of his arrival in the host State or immediately before, a resident of the other Contracting State.

The paragraph applies to certain items of income. These are the following: (1) all remittances from abroad for maintenance, education or training; (2) grants, allowances or awards; and (3) all remuneration from personal services rendered in the host State with a view to supplementing the resources available to him for such purposes to the extent of \$8,000 United States dollars or its equivalent in Bangladesh taka per taxable year.

The reference in paragraph 2 to “primary purpose” meant to describe individuals participating in a full time program of study, training or research, the term used in the U.S. Model. “Primary purpose” was substituted for the reference in the OECD Model to “exclusive purpose” to prevent too narrow an interpretation. It is not the intention to exclude full time students who, in accordance with their visas, may hold part-time employment jobs.

A student must be studying at a university, college, or other recognized educational institution. An educational institution is understood to be an institution that



normally maintains a regular faculty and normally has a regular body of students in attendance at the place where the educational activities are carried on. An educational institution will be considered to be recognized if it is accredited by an authority that generally is responsible for accreditation of institutions in the particular field of study.

The host-country exemption in the paragraph applies in subparagraph (c)(i) to payments received by the student from abroad for the purpose of his maintenance, education or training. A payment will be considered to be from abroad if the payor is located outside the host State. In all cases substance over form should prevail in determining the identity of the payor. Consequently, payments made directly or indirectly by the U.S. person with whom a visitor is training, but which have been routed through a non-host-country source, such as, for example, a foreign bank account, should not be treated as arising outside the United States for this purpose.

The monetary limits provided in paragraph 2(c)(ii) are in addition to, and not in lieu of, other exemptions provided by the Code. Thus, an unmarried resident of Bangladesh who is temporarily present in the United States for the primary purpose of studying at a university would be entitled to exclude \$8,000 of income from the performance of personal services and, in addition, would be entitled to the personal exemption allowed by section 151 of the Code, as provided by section 873(b) of the Code.

In the case of an apprentice or business trainee, the benefits of the Article will extend only for a period not exceeding 2 years from the time that the visitor first arrives in the host country. If, however, an apprentice or trainee remains in the host country for a third year, he would not receive the benefits of the paragraph for that year, but would not retroactively lose the benefits of the paragraph for the first two years.

### *Paragraph 3*

Paragraph 3 establishes that the exemptions provided in this Article do not apply to income from research if such research is undertaken primarily for the private benefit of a specific person or persons. For example, personal service income arising from research at a corporate research facility would, in general, not qualify as exempt income.

### *Relation to other Articles*

The saving clause of paragraph 2 of Article 1 (Personal Scope) does not apply to this Article with respect to an individual who is neither a citizen of the host State nor has been admitted for permanent residence there. The saving clause, however, does apply with respect to citizens and permanent residents of the host State. Thus, a U.S. citizen who is a resident of Bangladesh and who visits the United States as a full-time student at an accredited university will not be exempt from U.S. tax on remittances from abroad that otherwise constitute U.S. taxable income. A person, however, who is not a U.S. citizen, and who visits the United States as a student and remains long enough to become a

resident under U.S. law, but does not become a permanent resident (i.e., does not acquire a green card), will be entitled to the full benefits of the Article.

## **ARTICLE 22 (OTHER INCOME)**

Article 22 generally assigns taxing jurisdiction over income not dealt with in the other articles (Articles 6 through 16 and 18 through 21) of the Convention to the State of residence of the beneficial owner of the income and defines the terms necessary to apply the article. However, the other State may also tax such income if it arises in the other State. An item of income is “dealt with” in another article if it is the type of income described in the article and it has its source in a Contracting State. For example, all royalty income that arises in a Contracting State and that is beneficially owned by a resident of the other Contracting State is “dealt with” in Article 12 (Royalties).

Examples of items of income commonly covered by Article 22 include income from gambling, punitive (but not compensatory) damages, covenants not to compete, and income from certain financial instruments to the extent derived by persons not engaged in the trade or business of dealing in such instruments (unless the transaction giving rise to the income is related to a trade or business, in which case it is dealt with under Article 7 (Business Profits)). The article also applies to items of income that are not dealt with in the other articles because of their source or some other characteristic. For example, Article 11 (Interest) addresses only the taxation of interest having its source in a Contracting State. Interest arising in a third State that is not attributable to a permanent establishment in a Contracting State and therefore is subject to Article 22.

Distributions from partnerships and distributions from trusts are not generally dealt with in Article 22 because partnership and trust distributions generally do not constitute income. Under the Code, partners include in income their distributive share of partnership income annually, and partnership distributions themselves generally do not give rise to income. Also, under the Code, trust income and distributions have the character of the associated distributable net income and therefore would generally be covered by another article of the Convention. See, Code section 641 et seq.

### *Paragraph 1*

Paragraph 1 provides that items of income not dealt with in other articles that are earned by a resident of a Contracting State generally will be taxable only in the State of residence. This right of taxation applies whether or not the residence State exercises its right to tax the income covered by the Article. The residence taxation provided by paragraph 1 applies only when a resident of a Contracting State is the beneficial owner of the income. This is understood from the phrase “income of a resident of a Contracting State.” Thus, source taxation of income not dealt with in other articles of the Convention is not limited by paragraph 1 if it is nominally paid to a resident of the other Contracting State, but is beneficially owned by a resident of a third State.

### *Paragraph 2*

Paragraph 2 provides an exception to the general rule of paragraph 1 for income, other than income from real property, that is attributable to a permanent establishment or fixed base maintained in a Contracting State by a resident of the other Contracting State. The taxation of such income is governed by the provisions of Articles 7 (Business Profits) and 15 (Independent Personal Services). Therefore, income arising outside the United States that is attributable to a permanent establishment maintained in the United States by a resident of Bangladesh generally would be taxable by the United States under the provisions of Article 7. This would be true even if the income is sourced in a third State.

The provisions of paragraph 8 of Article 7 (Business Profits) apply to this paragraph. For example, other income that is attributable to a permanent establishment or a fixed base and that accrues during the existence of the permanent establishment or fixed base, but is received after the permanent establishment or fixed base no longer exists, remains taxable under the provisions of Articles 7 (Business Profits) or 15 (Independent Personal Services), respectively, and not under this Article.

### *Paragraph 3*

Paragraph 3 is not found in the U.S. or OECD Models. It is taken from the U.N. Model. It modifies the general rule of paragraph 1. It provides that, notwithstanding paragraphs 1 and 2, items of income of a resident of a Contracting State not dealt with in the other articles of the Convention and arising in the other Contracting State may also be taxed in that other Contracting State. Thus, gambling income of a resident of the United States that arises in Bangladesh may be taxed both in the United States and in Bangladesh. Paragraph 1, therefore, provides exclusive residence-based taxation only to income of a resident of a Contracting State that does not arise in the other Contracting State.

### *Relation to Other Articles*

This Article is subject to the saving clause of paragraph 2 of Article 1 (Personal Scope). Thus, the United States may tax the income of a resident of Bangladesh that is not dealt with elsewhere in the Convention, if that resident is a citizen of the United States. The Article is also subject to the provisions of Article 17 (Limitation on Benefits). Thus, if a resident of Bangladesh earns income that falls within the scope of paragraph 1 of Article 22, but that is taxable by the United States under U.S. law, the income would be exempt from U.S. tax under the provisions of Article 22 only if the resident satisfies one of the tests of Article 17 for entitlement to benefits.

## **ARTICLE 23 (RELIEF FROM DOUBLE TAXATION)**

This Article describes the manner in which each Contracting State undertakes to relieve double taxation. The United States and Bangladesh both use the foreign tax credit method under internal law and by treaty.

### *Paragraph 1*

The United States agrees, in paragraph 1, to allow to its citizens and residents a credit against U.S. tax for income taxes paid or accrued to Bangladesh. Paragraph 1 also provides that Bangladesh's covered taxes are income taxes for U.S. purposes. This provision is based on the Treasury Department's review of Bangladesh's laws.

The credit under the Convention is allowed in accordance with the provisions and subject to the limitations of U.S. law, as that law may be amended over time, so long as the general principle of this Article (i.e., the allowance of a credit) is retained. Thus, although the Convention provides for a foreign tax credit, the terms of the credit are determined by the provisions, at the time a credit is given, of the U.S. statutory credit.

Paragraph 1 provides for a deemed-paid credit, consistent with section 902 of the Code, to a U.S. corporation in respect of dividends received from a corporation resident in Bangladesh of which the U.S. corporation owns at least 10 percent of the voting stock. This credit is for the tax paid by the Bangladesh corporation on the profits out of which the dividends are considered paid.

As indicated, the U.S. credit under the Convention is subject to the various limitations of U.S. law (see Code sections 901 - 908). For example, the credit against U.S. tax generally is limited to the amount of U.S. tax due with respect to net foreign source income within the relevant foreign tax credit limitation category (see Code section 904(a) and (d)), and the dollar amount of the credit is determined in accordance with U.S. currency translation rules (see, e.g., Code section 985). Similarly, U.S. law applies to determine carryover periods for excess credits and other inter-year adjustments.

Furthermore, nothing in the Convention prevents the limitation of the U.S. credit from being applied on a per-country basis (should internal law be changed), an overall basis, or to particular categories of income (see, e.g., Code section 865(h)).

The Exchange of Notes provides that if the United States includes a tax sparing credit in any future treaty, the United States agrees that it will reopen negotiations with Bangladesh with a view to concluding a protocol that will grant tax sparing credit to U.S. investors deriving income from Bangladesh.

### *Paragraph 2*

Paragraph 2 contains the rules under which Bangladesh will avoid double taxation under the Convention. Under this paragraph, Bangladesh agrees to allow a credit to a

resident of Bangladesh deriving income from the United States for United States tax paid (as defined in subparagraph 2(a) and 3 of Article 2), to the extent it is paid in accordance with the Convention. The credit is for the full amount of United States tax, but not to exceed the Bangladesh tax on that income.

The paragraph also provides for a deemed-paid credit to a Bangladesh corporation in respect of dividends received from a corporation resident in the United States of which the Bangladesh corporation controls, directly or indirectly, at least 10 percent of the voting power. This credit is for the tax by the U.S. corporation on the profits but of which the dividends are paid in addition to the U.S. tax paid by the Bangladesh corporation on the dividend itself.

### *Paragraph 3*

Paragraph 3 provides special rules for the tax treatment in both States of certain types of income derived from U.S. sources by U.S. citizens who are resident Bangladesh. Since U.S. citizens, regardless of residence, are subject to U.S. tax at ordinary progressive rates on their worldwide income, the U.S. tax on the U.S. source income of a U.S. citizen resident in Bangladesh may exceed the U.S. tax that may be imposed under the Convention on an item of U.S. source income derived by a resident of Bangladesh who is not a U.S. citizen.

Subparagraph (a) of paragraph 3 provides special credit rules for Bangladesh with respect to items of income that are either exempt from U.S. tax or subject to reduced rates of U.S. tax under the provisions of the Convention when received by residents of Bangladesh who are not U.S. citizens. The tax credit of Bangladesh allowed by paragraph 3(a) under these circumstances, to the extent consistent with Bangladesh law, need not exceed the U.S. tax that may be imposed under the provisions of the Convention, other than tax imposed solely by reason of the U.S. citizenship of the taxpayer under the provisions of the saving clause of paragraph 2 of Article 1 (Personal Scope). Thus, if a U.S. citizen resident in Bangladesh receives U.S. source portfolio dividends, the foreign tax credit granted by Bangladesh would be limited to 15 percent of the dividend -- the U.S. tax that may be imposed under subparagraph 2(b) of Article 10 (Dividends) -- even if the shareholder is subject to U.S. net income tax because of his U.S. citizenship

Paragraph 3(b) eliminates the potential for double taxation that can arise because subparagraph 3(a) provides that Bangladesh need not provide full relief for the U.S. tax imposed on its citizens resident in Bangladesh. The subparagraph provides that the United States will credit the income tax paid or accrued to Bangladesh, after the application of subparagraph 3(a). It further provides that in allowing the credit, the United States will not reduce its tax below the amount that is taken into account in Bangladesh in applying subparagraph 3(a). Since the income described in paragraph 3 is U.S. source income, special rules are required to resource some of the income to Bangladesh in order for the United States to be able to credit Bangladesh tax. This resourcing is provided for in subparagraph 3(c), which deems the items of income referred to in subparagraph 3(a) to be from foreign sources to the extent necessary to

avoid double taxation under paragraph 3(b). The rules of paragraph 3(c) apply only for purposes of determining U.S. foreign tax credits with respect to taxes referred to in paragraphs 2(b) and 3 of Article 2 (Taxes Covered).

The following two examples illustrate the application of paragraph 3 in the case of a U.S. source portfolio dividend received by a U.S. citizen resident in Bangladesh. In both examples, the U.S. rate of tax on residents of Bangladesh under paragraph 2(b) of Article 10 (Dividends) of the Convention is 15 percent. In both examples the U.S. income tax rate on the U.S. citizen is 36 percent. In example I, the Bangladesh income tax rate on its resident (the U.S. citizen) is 25 percent (below the U.S. rate), and in example II, the rate on its resident is 40 percent (above the U.S. rate).

	Example I	Example II
Paragraph 3(a)		
U.S. dividend declared	\$100.00	\$100.00
Notional U.S. withholding tax per Article 10(2) (b)	15.00	15.00
Bangladesh taxable income	100.00	100.00
Bangladesh tax before credit	25.00	40.00
Bangladesh foreign tax credit	15.00	15.00
Net post-credit Bangladesh tax	10.00	25.00
Paragraphs 3(b) and (c)		
U.S. pre-tax income	\$100.00	\$100.00
U.S. pre-credit citizenship tax	36.00	36.00
Notional U.S. withholding tax	15.00	15.00
U.S. tax available for credit	21.00	21.00
Income resourced from U.S. to Bangladesh	27.77	58.33
U.S. tax on resourced income	10.00	21.00
U.S. credit for Bangladesh tax	10.00	21.00
Net post-credit U.S. tax	11.00	0.00
Total U.S. tax	26.00	15.00

In both examples, in the application of paragraph 3(a), the Bangladesh credits a 15 percent U.S. tax against its residence tax on the U.S. citizen. In example I the net Bangladesh tax after foreign tax credit is \$10.00; in the second example it is \$25.00. In the application of paragraphs 3(b) and (c), from the U.S. tax due before credit of \$36.00, the United States subtracts the amount of the U.S. source tax of \$15.00, against which no U.S. foreign tax credit is to be allowed. This provision assures that the United States will collect the tax that it is due under the Convention as the source country. In both examples, the maximum amount of U.S. tax against which credit for Bangladesh tax may be claimed is \$21.00. Initially, all of the income in these examples was U.S. source. In order for a U.S. credit to be allowed for the full amount of the Bangladesh tax, an appropriate amount of the income must be resourced. The amount that must be resourced depends on the amount of Bangladesh tax for which the U.S. citizen is claiming a U.S. foreign tax credit. In example I, the Bangladesh tax was \$10.00. In order for this amount to be creditable against U.S. tax, \$27.77 (\$10 divided by .36) must be resourced as

foreign source. When the Bangladesh tax is credited against the U.S. tax on the resourced income, there is a net U.S. tax of \$11.00 due after credit. In example II, Bangladesh tax was \$25 but, because the amount available for credit is reduced under subparagraph 3(c) by the amount of the U.S. source tax, only \$21.00 is eligible for credit. Accordingly, the amount that must be resourced is limited to the amount necessary to ensure a foreign tax credit for \$21 of Bangladesh tax, or \$58.33 (\$21 divided by .36). Thus, even though Bangladesh tax was \$25.00 and the U.S. tax available for credit was \$21.00, there is no excess credit available for carryover.

#### *Relation to other articles*

By virtue of the exceptions in subparagraph 3(a) of Article 1 (Personal Scope) this Article is not subject to the saving clause of paragraph 2 of Article 1. Thus, the United States will allow a credit to its citizens and residents in accordance with the Article, even if such credit were to provide a benefit not available under the Code.

#### **ARTICLE 24 (NONDISCRIMINATION)**

This Article assures that nationals of a Contracting State, in the case of paragraph 1, and residents of a Contracting State, in the case of paragraphs 2 through 4, will not be subject, directly or indirectly, to discriminatory taxation in the other Contracting State. For this purpose, nondiscrimination means providing national treatment. Not all differences in tax treatment, either as between nationals of the two States, or between residents of the two States, are violations of this national treatment standard. Rather, the national treatment obligation of this Article applies only if the nationals or residents of the two States are comparably situated.

Each of the relevant paragraphs of the Article provides that two persons that are comparably situated must be treated similarly. Although the actual words differ from paragraph to paragraph (e.g., paragraph 1 refers to two nationals “in the same circumstances,” paragraph 2 refers to two enterprises “carrying on the same activities” and paragraph 4 refers to two enterprises that are “similar”), the common underlying premise is that if the difference in treatment is directly related to a tax-relevant difference in the situations of the domestic and foreign persons being compared, that difference is not to be treated as discriminatory (e.g., if one person is taxable in a Contracting State on worldwide income and the other is not, or if tax may be collectible from one person at a later stage, but not from the other, distinctions in treatment would be justified under paragraph 1). Other examples of such factors that can lead to nondiscriminatory differences in treatment will be noted in the discussions of each paragraph.

The operative paragraphs of the Article also use different language to identify the kinds of differences in taxation treatment that will be considered discriminatory. For example, paragraphs 1 and 4 speak of “any taxation or any requirement connected therewith that is other or more burdensome,” while paragraph 2 specifies that a tax “shall not be less favorably levied.” Regardless of these differences in language, only

differences in tax treatment that materially disadvantage the foreign person relative to the domestic person are properly the subject of the Article.

Paragraph 1 provides that a national of one Contracting State may not be subject to taxation or connected requirements in the other Contracting State that are different from, or more burdensome than, the taxes and connected requirements imposed upon a national of that other State in the same circumstances. As noted above, whether or not the two persons are both taxable on worldwide income is a significant circumstance for this purpose. Although, unlike the U.S. Model, the text does not specifically refer to “taxation on worldwide income” as a relevant circumstance, the paragraph should be clearly understood to identify taxation on worldwide income as a relevant circumstance. This is confirmed by the penultimate sentence of the paragraph, which states that the United States is not required to apply the same taxing regime to a national of Bangladesh who is not resident in the United States and a U.S. national who is not resident in the United States. United States citizens who are not residents of the United States but who are, nevertheless, subject to United States tax on their worldwide income are not in the same circumstances with respect to United States taxation as citizens of Bangladesh who are not United States residents. Thus, for example, Article 24 would not entitle a national of Bangladesh resident in a third country to taxation at graduated rates on U.S. source dividends or other investment income that applies to a U.S. citizen resident in the same third country.

A national of a Contracting State is afforded protection under this paragraph even if the national is not a resident of either Contracting State. Thus, a U.S. citizen who is resident in a third country is entitled, under this paragraph, to the same treatment in Bangladesh as a citizen of Bangladesh who is in similar circumstances (i.e., who is resident in a third State). The term “national” in relation to a Contracting State is defined in subparagraph 1(h) of Article 3 (General Definitions). The term includes both individuals and juridical persons.

#### *Paragraph 2*

Paragraph 2 of the Article provides that a Contracting State may not tax a permanent establishment or fixed base of an enterprise of the other Contracting State less favorably than an enterprise of that first-mentioned State that is carrying on the same activities.

The fact that a U.S. permanent establishment of an enterprise of Bangladesh is subject to U.S. tax only on income that is attributable to the permanent establishment, while a U.S. corporation engaged in the same activities is taxable on its worldwide income is not, in itself, a sufficient difference to deny national treatment to the permanent establishment. There are cases, however, where the two enterprises would not be similarly situated and differences in treatment may be warranted. For instance, it would not be a violation of the nondiscrimination protection of paragraph 2 to require the Bangladesh enterprise to provide information in a reasonable manner that may be different from the information requirements imposed on a U.S. enterprise, because



information may not be as readily available to the Internal Revenue Service from a foreign as from a domestic enterprise. Similarly, it would not be a violation of paragraph 2 to impose penalties on persons who fail to comply with such a requirement (see, e.g., sections 874(a) and 882(c)(2)). Further, a determination that income and expenses have been attributed or allocated to a permanent establishment in conformity with the principles of Article 7 (Business Profits) implies that the attribution or allocation was not discriminatory.

Section 1446 of the Code imposes on any partnership with income that is effectively connected with a U.S. trade or business the obligation to withhold tax on amounts allocable to a foreign partner. In the context of the Convention, this obligation applies with respect to a share of the partnership income of a partner resident in Bangladesh, and attributable to a U.S. permanent establishment. There is no similar obligation with respect to the distributive shares of U.S. resident partners. It is understood, however, that this distinction is not a form of discrimination within the meaning of paragraph 2 of the Article. No distinction is made between U.S. and non-U.S. partnerships, since the law requires that partnerships of both U.S. and non-U.S. domicile withhold tax in respect of the partnership shares of non-U.S. partners. Furthermore, in distinguishing between U.S. and non-U.S. partners, the requirement to withhold on the non-U.S. but not the U.S. partner's share is not discriminatory taxation, but, like other withholding on nonresident aliens, is merely a reasonable method for the collection of tax from persons who are not continually present in the United States, and as to whom it otherwise may be difficult for the United States to enforce its tax jurisdiction. If tax has been over-withheld, the partner can, as in other cases of over-withholding, file for a refund.

Paragraph 2 obligates the host State to provide national treatment not only to permanent establishments of an enterprise of the partner, but also to other residents of the partner that are taxable in the host State on a net basis because they derive income from independent personal services performed in the host State that is attributable to a fixed base in that State. Thus, an individual resident of the other Contracting State who performs independent personal services in the U.S. and who is subject to U.S. income tax on the income from those services that is attributable to a fixed base in the United States, is entitled to no less favorable tax treatment in the United States than a U.S. resident engaged in the same kinds of activities. With such a rule in a treaty, the host State cannot tax its own residents on a net basis, but disallow deductions (other than personal allowances, etc.) with respect to the income attributable to the fixed base. Similarly, in accordance with Article 6 (Income from Immovable Property), the situs State would be required to allow deductions to a resident of the other State with respect to income derived from real property located in the situs State to the same extent that deductions are allowed to residents of the situs State (other than personal allowances, etc., as provided in paragraph (5) with respect to income derived from real property located in the situs State.

### *Paragraph 3*

Paragraph prohibits the discrimination in the allowance of deductions. When an enterprise of a Contracting State pays interest, royalties or other disbursements to a resident of the other Contracting State, the first-mentioned Contracting State must allow a deduction for those payments in computing the taxable profits of the enterprise as if the payment had been made under the same conditions to a resident of the first-mentioned Contracting State. An exception to this rule is provided for cases where the provisions of paragraph 1 of Article 9 (Associated Enterprises), paragraph 5 of Article 11 (Interest) or paragraph 5 of Article 12 (Royalties) apply, because all of these provisions permit the denial of deductions in certain circumstances in respect of transactions between related persons. This exception would include the denial or deferral of certain interest deductions under Code section 163(j).

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 that includes the person incurring the expense.

Paragraph 3 also contains a rule related specifically to a provision of Bangladesh law. It provides that rules of paragraph 2 will not affect the requirement in Bangladesh law that Bangladesh payors of interest, royalties and other disbursements to residents of the United States deduct tax at source from those payments as a necessary condition for taking a deduction for the payment against income for income tax purposes.

Paragraph 3 also provides that any debts of an enterprise of a Contracting State to a resident of the other Contracting State are deductible in the first-mentioned Contracting State for computing the capital tax of the enterprise under the same conditions as if the debt had been contracted to a resident of the first-mentioned Contracting State. Even though, for general purposes, the Convention covers only income taxes, under paragraph 7 of this Article, the nondiscrimination provisions apply to all taxes levied in both Contracting States, at all levels of government. Thus, this provision may be relevant for both States. The other Contracting State may have capital taxes and in the United States such taxes are imposed by local governments.

### *Paragraph 4*

Paragraph 4 requires that a Contracting State not impose taxation or connected requirements on an enterprise of that State that is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, that is different from or more burdensome than the taxation or connected requirements that it imposes on other similar enterprises of that first-mentioned Contracting State. For this purpose it is understood that “similar” refers to similar activities or ownership of the enterprise.

This rule, like all nondiscrimination provisions, does not prohibit differing treatment of entities that are in differing circumstances. Rather, a protected enterprise is only required to be treated in the same manner as other enterprises that, from the point of view of the application of the tax law, are in substantially similar circumstances both in law and in fact. The taxation of a distributing corporation under section 367(e) on an applicable distribution to foreign shareholders does not violate paragraph 4 of the Article because a foreign-owned corporation is not similar to a domestically-owned corporation that is accorded nonrecognition treatment under sections 337 and 355.

For the reasons given above in connection with the discussion of paragraph 2 of the Article, it is also understood that the provision in section 1446 of the Code for withholding of tax on non-U.S. partners does not violate paragraph 4 of the Article.

It is further understood that the ineligibility of a U.S. corporation with nonresident alien shareholders to make an election to be an “S” corporation does not violate paragraph 4 of the Article. If a corporation elects to be an S corporation (requiring 35 or fewer shareholders), it is generally not subject to income tax and the shareholders take into account their pro rata shares of the corporation's items of income, loss, deduction or credit. A nonresident alien does not pay U.S. tax on a net basis, and, thus, does not generally take into account items of loss, deduction or credit. Thus, the S corporation provisions do not exclude corporations with nonresident alien shareholders because such shareholders are foreign, but only because they are not net-basis taxpayers. Similarly, the provisions exclude corporations with other types of shareholders where the purpose of the provisions cannot be fulfilled or their mechanics implemented. For example, corporations with corporate shareholders are excluded because the purpose of the provisions to permit individuals to conduct a business in corporate form at individual tax rates would not be furthered by their inclusion.

#### *Paragraph 5*

This paragraph provides that a Contracting State is not obligated to grant to a resident of the other Contracting State any tax allowances, reliefs, etc., that it grants to its own residents on account of their civil status or family responsibilities. Thus, if a sole proprietor who is a resident of Bangladesh has a permanent establishment in the United States, in assessing income tax on the profits attributable to the permanent establishment, the United States is not obligated to allow to the Bangladesh resident the personal allowances for himself and his family that he would be permitted to take if the permanent establishment were a sole proprietorship owned and operated by a U.S. resident, despite the fact that the individual income tax rates would apply.

#### *Paragraph 6*

Paragraph 6 of the Article confirms that no provision of the Article will prevent either Contracting State from imposing the branch tax described in Article 14 (Branch Tax).

### *Paragraph 7*

As noted above, notwithstanding the specification of taxes covered by the Convention in Article 2 (Taxes Covered) for general purposes, for purposes of providing nondiscrimination protection this Article applies to taxes of every kind and description imposed by a Contracting State or a political subdivision or local authority thereof. Customs duties are not considered to be taxes for this purpose.

### *Relation to Other Articles*

The saving clause of paragraph 2 of Article 1 (Personal Scope) does not apply to this Article, by virtue of the exceptions in paragraph 3(a) of Article 1. Thus, for example, a U.S. citizen who is a resident of Bangladesh may claim benefits in the United States under this Article.

Nationals of a Contracting State may claim the benefits of paragraph 1 regardless of whether they are entitled to benefits under Article 17 (Limitation on Benefits), because that paragraph applies to nationals and not residents. They may not claim the benefits of the other paragraphs of this Article with respect to an item of income unless they are generally entitled to treaty benefits with respect to that income under a provision of Article 17.

## **ARTICLE 25 (MUTUAL AGREEMENT PROCEDURE)**

This Article provides the mechanism for taxpayers to bring to the attention of competent authorities issues and problems that may arise under the Convention. It also provides a mechanism for cooperation between the competent authorities of the Contracting States to resolve disputes and clarify issues that may arise under the Convention and to resolve cases of double taxation not provided for in the Convention. The competent authorities of the two Contracting States are identified in paragraph 1(e) of Article 3 (General Definitions).

### *Paragraph 1*

This paragraph provides that where a resident of a Contracting State considers that the actions of one or both Contracting States will result in taxation that is not in accordance with the Convention he may present his case to the competent authority of either Contracting State. Allowing a person to bring a case to either competent authority follows the U.S. Model provision, which is based on paragraph 16 of the Commentary to Article 25 of the OECD Model, which suggests that countries may agree to allow a case to be brought to either competent authority. There is no apparent reason why a resident of a Contracting State must take its case to the competent authority of its State of residence and not to that of the partner. Under this approach, for example, a U.S. permanent establishment of a corporate resident in Bangladesh that faces inconsistent treatment in

the two countries would be able to bring its complaint to the competent authority in either Contracting State.

Although the typical cases brought under this paragraph will involve economic double taxation arising from transfer pricing adjustments, the scope of this paragraph is not limited to such cases. For example, if a Contracting State treats income derived by a company resident in the other Contracting State as attributable to a permanent establishment in the first-mentioned Contracting State, and the resident believes that the income is not attributable to a permanent establishment, or that no permanent establishment exists, the resident may bring a complaint under paragraph 1 to the competent authority of either Contracting State.

It is not necessary for a person bringing a complaint first to have exhausted the remedies provided under the national laws of the Contracting States before presenting a case to the competent authorities, nor does the fact that the statute of limitations may have passed for seeking a refund preclude bringing a case to the competent authority. No time limit is provided within which a case must be brought, and assessment and collection procedures are suspended while the agreement procedure is pending.

#### *Paragraph 2*

This paragraph provides certain rules for the competent authorities to follow in dealing with cases brought by taxpayers under paragraph 1. It provides that if the competent authority of the Contracting State to which the case is presented judges the case to have merit, and cannot reach a unilateral solution, it shall seek an agreement with the competent authority of the other Contracting State pursuant to which taxation not in accordance with the Convention will be avoided. During the period that a proceeding under this Article is pending, any assessment and collection procedures shall be suspended. Any agreement is to be implemented even if such implementation otherwise would be barred by the statute of limitations or by some other procedural limitation, such as a closing agreement. In a case where the taxpayer has entered a closing agreement (or other written settlement) with the United States prior to bringing a case to the competent authorities, the U.S. competent authority will endeavor only to obtain a correlative adjustment from the other Contracting State. See, Rev. Proc. 2002-52, 2002-31 I.R.B. 242, Section 7.04. Because, as specified in paragraph 2 of Article 27 (Effect of Convention on Diplomatic Agents and Consular Officers, Domestic Laws, and Other Treaties), the Convention cannot operate to increase a taxpayer's liability, time or other procedural limitations can be overridden only for the purpose of making refunds and not to impose additional tax.

#### *Paragraph 3*

Paragraph 3 authorizes the competent authorities to resolve difficulties or doubts that may arise as to the application or interpretation of the Convention. The paragraph includes a non-exhaustive list of examples of the kinds of matters about which the competent authorities may reach agreement. This list is purely illustrative; it does not

grant any authority that is not implicitly present as a result of the introductory sentence of paragraph 3. The competent authorities may, for example, agree to the same attribution of income, deductions, credits or allowances between an enterprise in one Contracting State and its permanent establishment in the other (subparagraph (a)) or between related persons (subparagraph (b)). These allocations are to be made in accordance with the arm's-length principle underlying Article 7 (Business Profits) and Article 9 (Associated Enterprises). Agreements reached under these subparagraphs may include agreement on a methodology for determining an appropriate transfer price, common treatment of a taxpayer's cost sharing arrangement, or upon an acceptable range of results under that methodology. Subparagraph (b) also specifies that the competent authorities may agree on the application of paragraph 2 of Article 24 (Nondiscrimination), dealing with the taxation of permanent establishments.

As indicated in subparagraphs (c), (d) and (e), the competent authorities also may agree to settle a variety of conflicting applications of the Convention. They may agree to characterize particular items of income in the same way (subparagraph(c)), to apply the same source rules to particular items of income (subparagraph (d)), and to adopt a common meaning of a term (subparagraph (e)).

Since the list under paragraph 3 is not exhaustive, the competent authorities may reach agreement on issues not enumerated in paragraph 3 if necessary to avoid double taxation. For example, the competent authorities may seek agreement on a uniform set of standards for the use of exchange rates, or agree on consistent timing of gain recognition with respect to a transaction to the extent necessary to avoid double taxation.

Finally, paragraph 3 authorizes the competent authorities to consult for the purpose of eliminating double taxation in cases not provided for in the Convention and to resolve any difficulties or doubts arising as to the interpretation or application of the Convention. This provision is intended to permit the competent authorities to implement the treaty in particular cases in a manner that is consistent with its expressed general purposes. It permits the competent authorities to deal with cases that are within the spirit of the provisions but that are not specifically covered. An example of such a case might be double taxation arising from a transfer pricing adjustment between two permanent establishments of a third-country resident, one in the United States and one in Bangladesh. Since no resident of a Contracting State is involved in the case, the Convention does not apply, but the competent authorities nevertheless may use the authority of the Convention to prevent the double taxation.

Agreements reached by the competent authorities under paragraph 3 need not conform to the internal law provisions of either Contracting State. Paragraph 3 is not, however, intended to authorize the competent authorities to resolve problems of major policy significance that normally would be the subject of negotiations between the Contracting States themselves. For example, this provision would not authorize the competent authorities to agree to allow a U.S. foreign tax credit under the treaty for a tax imposed by Bangladesh where that tax is not otherwise a covered tax and is not an

identical or substantially similar tax imposed after the date of signature of the treaty. Whether or not the tax is creditable under the Code is a separate matter.

#### *Paragraph 4*

Paragraph 4 provides that the competent authorities may communicate with each other for the purpose of reaching an agreement. This makes clear that the competent authorities of the two Contracting States may communicate without going through diplomatic channels. Such communication may be in various forms, including, where appropriate, through face-to-face meetings of representatives of the competent authorities.

#### *Paragraph 5*

Paragraph 5 authorizes the competent authorities to increase any dollar amounts referred to in the Convention. Such changes would be intended to reflect economic and monetary developments. Under the Convention, this provision refers to Article 18 (Entertainers and Athletes) and Article 21 (Teachers, Students and Trainees). The rule under paragraph 5 is intended to operate as follows: if, for example, after the Convention has been in force for some time, inflation rates have been such as to make the \$10,000 exemption threshold for entertainers unrealistically low in terms of the original objectives intended in setting the threshold, the competent authorities may agree to a higher threshold without the need for formal amendment to the treaty and ratification by the Contracting States. This authority can be exercised, however, only to the extent necessary to restore those original objectives. Because of paragraph 2 of Article 27 (Effect of Convention on Diplomatic Agents and Consular Officers, Domestic Laws, and Other Treaties), it is clear that this provision can be applied only to the benefit of taxpayers, i.e., only to increase dollar thresholds, not to reduce them.

#### *Other Issues*

##### *Treaty effective dates and termination in relation to competent authority dispute resolution*

A case may be raised by a taxpayer under a treaty with respect to a year for which a treaty was in force after the treaty has been terminated. In such a case the ability of the competent authorities to act is limited. They may not exchange confidential information, nor may they reach a solution that varies from that specified in its law.

A case also may be brought to a competent authority under a treaty that is in force, but with respect to a year prior to the entry into force of the treaty. The scope of the competent authorities to address such a case is not constrained by the fact that the treaty was not in force when the transactions at issue occurred, and the competent authorities have available to them the full range of remedies afforded under this Article.

### *Triangular competent authority solutions*

International tax cases may involve more than two taxing jurisdictions (e.g., transactions among a parent corporation resident in country A and its subsidiaries resident in countries B and C). As long as there is a complete network of treaties, among the three countries, it should be possible, under the full combination of bilateral authorities, for the competent authorities of the three States to work together on a three-sided solution. Although country A may not be able to give information received under Article 26 (Exchange of Information and Administrative Assistance) from country B to the authorities of country C, if the competent authorities of the three countries are working together, it should not be a problem for them to arrange for the authorities of country B to give the necessary information directly to the tax authorities of country C, as well as to those of country A. Each bilateral part of the trilateral solution must, of course, not exceed the scope of the authority of the competent authorities under the relevant bilateral treaty.

### *Relation to Other Articles*

This Article is not subject to the saving clause of paragraph 2 of Article 1 (Personal Scope) by virtue of the exceptions in paragraph 3(a) of that Article. Thus, rules, definitions, procedures, etc. that are agreed upon by the competent authorities under this Article may be applied by the United States with respect to its citizens and residents even if they differ from the comparable Code provisions. Similarly, as indicated above, U.S. law may be overridden to provide refunds of tax to a U.S. citizen or resident under this Article. A person may seek relief under Article 25 regardless of whether he is generally entitled to benefits under Article 17 (Limitation on Benefits). As in all other cases, the competent authority is vested with the discretion to decide whether the claim for relief is justified.

## **ARTICLE 26 (EXCHANGE OF INFORMATION AND ADMINISTRATIVE ASSISTANCE)**

### *Paragraph 1*

This Article provides for the exchange of information between the competent authorities of the Contracting States. The information to be exchanged is that which is necessary for carrying out the provisions of the Convention or the domestic laws of the United States or of Bangladesh concerning the taxes covered by the Convention. Like the OECD Model and earlier U.S. Models, but unlike the most recent U.S. Model, paragraph 1 refers to information that is “necessary” for carrying out the provisions of the Convention or domestic law. This term consistently has been interpreted as being equivalent to the term “relevant” as used in the most recent U.S. Model. Thus use of the term “necessary” does not require a requesting State to demonstrate that it would be prevented from enforcing its tax laws unless it obtained a particular item of information.



The taxes covered by the Convention for purposes of this Article are those referred to in Article 2 (Taxes Covered). Bangladesh was not able to extend the coverage to all national level taxes, as in the U.S. and OECD Models.

Exchange of information with respect to each State's domestic law is authorized insofar as the taxation under those domestic laws is not contrary to the Convention. Thus, for example, information may be exchanged with respect to a covered tax, even if the transaction to which the information relates is a purely domestic transaction in the requesting State and, therefore, the exchange is not made for the purpose of carrying out the Convention. An example of such a case is provided in the OECD Commentary: A company resident in the United States and a company resident in Bangladesh transact business between themselves through a third-country resident company. Neither Contracting State has a treaty with the third State. In order to enforce their internal laws with respect to transactions of their residents with the third-country company (since there is no relevant treaty in force), the United States and Bangladesh may exchange information regarding the prices that their residents paid in their transactions with the third-country resident.

Paragraph 1 states that information exchange is not restricted by Article 1 (Personal Scope). Accordingly, information may be requested and provided under this Article with respect to persons who are not residents of either Contracting State. For example, if a third-country resident has a permanent establishment in Bangladesh which engages in transactions with a U.S. enterprise, the United States could request information with respect to that permanent establishment, even though it is not a resident of either Contracting State. Similarly, if a third-country resident maintains a bank account in Bangladesh, and the Internal Revenue Service has reason to believe that funds in that account should have been reported for U.S. tax purposes but have not been so reported, information can be requested from Bangladesh with respect to that person's account.

Paragraph 1 also provides assurances that any information exchanged will be treated as secret, subject to the same disclosure constraints as information obtained under the laws of the requesting State. Information received may be disclosed only to persons, including courts and administrative bodies, involved with the assessment, collection, or administration of, the enforcement or prosecution in respect of or determination of appeals in relation to, the taxes covered by the Convention. The information must be used by these persons in connection with these designated functions. The information also may be disclosed to legislative bodies, such as the tax-writing committees of Congress and the Government Accountability Office engaged in the oversight of the preceding activities. Information received by these bodies must be for use in the performance of their role in overseeing the administration of U.S. tax laws. Information received may be disclosed in public court proceedings or in judicial decisions

The Article authorizes the competent authorities to exchange information on a routine basis, on request in relation to a specific case, or spontaneously. It is contemplated that the Contracting States will utilize this authority to engage in all of these forms of information exchange, as appropriate.

### *Paragraph 2*

Paragraph 2 provides that the obligations undertaken in paragraph 1 to exchange information do not require a Contracting State to carry out administrative measures that are at variance with the laws or administrative practice of either State. Nor is a Contracting State required to supply information not obtainable under the laws or administrative practice of either State, or to disclose trade secrets or other information, the disclosure of which would be contrary to public policy. Thus, a requesting State cannot obtain information from the other State if the information would be obtained pursuant to procedures or measures that are broader than those available in the requesting State.

While paragraph 2 states conditions under which a Contracting State is not obligated to comply with a request from the other Contracting State for information, the requested State is not precluded from providing such information, and may, at its discretion, do so subject to the limitations of its internal law.

### *Paragraph 3*

Paragraph 3 sets forth two exceptions from the dispensations described in paragraph 2. First, subparagraph (a) of the paragraph provides that information must be provided to the requesting State notwithstanding the fact that disclosure of the information is precluded by bank secrecy or similar legislation relating to disclosure of financial information by financial institutions or intermediaries. This includes the disclosure of information regarding the beneficial owner of an interest in a person, such as the identity of a beneficial owner of bearer shares. Second, subparagraph (b) provides that when information is requested by a Contracting State in accordance with this Article the other Contracting State is obligated to obtain the requested information as if the tax in question were the tax of the requested State, even if that State has no direct tax interest in the case to which the request relates.

### *Paragraph 4*

Paragraph 4 provides that the requesting State may specify the form in which information is to be provided (e.g., depositions of witnesses and authenticated copies of original documents) so that the information can be usable in the judicial proceedings of the requesting State. The requested State should, if possible, provide the information in the form requested to the same extent that it can obtain information in that form under its own laws and administrative practices with respect to its own taxes.

### *Treaty effective dates and termination in relation to competent authority dispute resolution*

Once the Convention is in force, the competent authority may seek information under the Convention with respect to a year prior to the entry into force of the

Convention. The scope of the competent authorities to address such a case is not constrained by the fact that the Convention was not in force when the transactions at issue occurred, and the competent authorities have available to them the full range of information exchange provisions afforded under this Article.

A tax administration also may seek information with respect to a year for which a treaty was in force after the treaty has been terminated. In such a case, the ability of the other tax administration to act is limited. The treaty no longer provides authority for the tax administrations to exchange confidential information. They may only exchange information pursuant to domestic law.

## **ARTICLE 27 (DIPLOMATIC AGENTS AND CONSULAR OFFICERS, DOMESTIC LAWS, AND OTHER TREATIES)**

### *Paragraph 1*

This paragraph confirms that any fiscal privileges to which diplomatic or consular officials are entitled under general provisions of international law or under special agreements will apply notwithstanding any provisions to the contrary in the Convention. The agreements referred to include any bilateral agreements, such as consular conventions, that affect the taxation of diplomats and consular officials and any multilateral agreements dealing with these issues, such as the Vienna Convention on Diplomatic Relations and the Vienna Convention on Consular Relations. The U.S. generally adheres to the latter because its terms are consistent with customary international law.

The paragraph does not independently provide any benefits to diplomatic agents and consular officers. Article 20 (Government Service) does so, as do Code section 893 and a number of bilateral and multilateral agreements. Rather, the paragraph specifically reconfirms in this context the statement in paragraph 2 of this Article that nothing in the Convention will operate to restrict any benefit accorded by the general rules of international law or with any of the other agreements referred to above. In the event that there is a conflict between the tax treaty and international law or such other treaties, under which the diplomatic agent or consular official is entitled to greater benefits under the latter, the latter laws or agreements shall have precedence. Conversely, if the tax treaty confers a greater benefit than another agreement, the affected person could claim the benefit of the tax treaty.

### *Paragraph 2*

Paragraph 2, as noted above, states the generally accepted relationship both between the Convention and domestic law and between the Convention and other agreements between the Contracting States (i.e., that no provision in the Convention may restrict any exclusion, exemption, deduction, credit or other benefit accorded by the tax laws of the Contracting States, or by any other agreement between the Contracting

States). For example, if a deduction would be allowed under the Code in computing the U.S. taxable income of a resident of Bangladesh, the deduction also is allowed to that person in computing taxable income under the Convention. Paragraph 2 also means that the Convention may not increase the tax burden on a resident of a Contracting States beyond the burden determined under domestic law. Thus, a right to tax given by the Convention cannot be exercised unless that right also exists under internal law. The relationship between the nondiscrimination provisions of the Convention and other agreements is not addressed in paragraph 2 but in paragraph 3.

It follows that under the principle of paragraph 2 a taxpayer's liability to U.S. tax need not be determined under the Convention if the Code would produce a more favorable result. A taxpayer may not, however, choose among the provisions of the Code and the Convention in an inconsistent manner in order to minimize tax. For example, assume that a resident of Bangladesh has three separate businesses in the United States. One is a profitable permanent establishment and the other two are trades or businesses that would earn taxable income under the Code but that do not meet the permanent establishment threshold tests of the Convention. One is profitable and the other incurs a loss. Under the Convention, the income of the permanent establishment is taxable, and both the profit and loss of the other two businesses are ignored. Under the Code, all three would be subject to tax, but the loss would be offset against the profits of the two profitable ventures. The taxpayer may not invoke the Convention to exclude the profits of the profitable trade or business and invoke the Code to claim the loss of the loss trade or business against the profit of the permanent establishment. (See Rev. Rul. 84-17, 1984-1 C.B. 308). If, however, the taxpayer invokes the Code for the taxation of all three ventures, he would not be precluded from invoking the Convention with respect, for example, to any dividend income he may receive from the United States that is not effectively connected with any of his business activities in the United States.

Similarly, nothing in the Convention can be used to deny any benefit granted by any other agreement between the United States and the other Contracting State. For example, if certain benefits are provided for military personnel or military contractors under a Status of Forces Agreement between the United States and Bangladesh, those benefits or protections will be available to residents of the Contracting States regardless of any provisions to the contrary (or silence) in the Convention.

### *Paragraph 3*

Paragraph 3 specifically relates to nondiscrimination obligations of the Contracting States under other agreements. The provisions of paragraph 3 are an exception to the rule provided in paragraph 2 of this Article under which the Convention shall not restrict in any manner any benefit now or hereafter accorded by any other agreement between the Contracting States.

Subparagraph (a) of paragraph 3 provides that, notwithstanding any other agreement to which the Contracting States may be parties, a dispute concerning whether a

measure is within the scope of this Convention shall be considered only by the competent authorities of the Contracting States, and the procedures under this Convention exclusively shall apply to the dispute. Thus, procedures for dealing with disputes that may be incorporated into trade, investment, or other agreements between the Contracting States shall not apply for the purpose of determining the scope of the Convention.

Subparagraph (b) of paragraph 3 provides that, unless the competent authorities determine that a taxation measure is not within the scope of this Convention, the nondiscrimination obligations of this Convention exclusively shall apply with respect to that measure, except for such national treatment or most-favored-nation (“MFN”) obligation as may apply to trade in goods under the General Agreement on Tariffs and Trade (“GATT”). No national treatment or MFN obligation under any other agreement shall apply with respect to that measure. Thus, unless the competent authorities agree otherwise, any national treatment and MFN obligations undertaken by the Contracting States under agreements other than the Convention shall not apply to a taxation measure, with the exception of GATT as applicable to trade in goods.

Subparagraph (c) of paragraph 3 defines a “measure” broadly. It would include, for example, a law, regulation, rule, procedure, decision, administrative action or guidance, or any other form of measure.

#### *Relation to Other Articles*

Pursuant to subparagraph 3(b) of Article 1 (Personal Scope), the saving clause of paragraph 2 of Article 1 does not apply to override any benefits of this Article available to an individual who is neither a citizen of a Contracting State nor has immigrant status there.

### **ARTICLE 28 (ENTRY INTO FORCE)**

This Article contains the rules for bringing the Convention into force and giving effect to its provisions.

#### *Paragraph 1*

Paragraph 1 provides for the ratification of the Convention by both Contracting States according to their constitutional and statutory requirements. Instruments of ratification will be exchanged as soon as possible after both States' requirements for ratification have been complied with.

In the United States, the process leading to ratification and entry into force is as follows: Once a treaty has been signed by authorized representatives of the two Contracting States, the Department of State sends the treaty to the President who formally transmits it to the Senate for its advice and consent to ratification, which requires approval by two-thirds of the Senators present and voting. Prior to this vote, however, it generally has been the practice for the Senate Committee on Foreign Relations to hold

hearings on the treaty and make a recommendation regarding its approval to the full Senate. Both Government and private sector witnesses may testify at these hearings. After receiving the advice and consent of the Senate to ratification, the treaty is returned to the President for his signature on the ratification document. The President's signature on the document completes the process in the United States.

### *Paragraph 2*

Paragraph 2 provides that the Convention will enter into force on the date on which the instruments of ratification requirements are exchanged. The date on which a treaty enters into force is not necessarily the date on which its provisions take effect. Paragraph 2, therefore, also contains rules that determine when the provisions of the treaty will have effect. Under paragraph 2(a), the Convention will have effect with respect to taxes withheld at source (principally dividends, interest and royalties) for amounts paid or credited on or after the first day of the second month following the date on which the Convention enters into force. For example, if instruments of ratification are exchanged on April 25 of a given year, the withholding rates specified in paragraph 2 of Article 10 (Dividends) would be applicable to any dividends paid or credited on or after June 1 of that year. This rule allows the benefits of the withholding reductions to be put into effect as soon as possible, without waiting until the following year. The delay of one to two months is required to allow sufficient time for withholding agents to be informed about the change in withholding rates. If for some reason a withholding agent withholds at a higher rate than that provided by the Convention (perhaps because it was not able to re-program its computers before the payment is made), a beneficial owner of the income that is a resident of Bangladesh may make a claim for refund pursuant to section 1464 of the Code.

For all other taxes, paragraph 2(b) specifies that the Convention will have effect for any taxable period, in the United States, and income year, in Bangladesh, beginning on or after January 1 of the year following entry into force.

As discussed under Articles 25 (Mutual Agreement Procedure) and 26 (Exchange of Information and Administrative Assistance), the powers afforded the competent authority under those articles apply retroactively to taxable periods preceding entry into force.

## **ARTICLE 29 (TERMINATION)**

The Convention is to remain in effect indefinitely, unless terminated by one of the Contracting States in accordance with the provisions of Article 29. The Convention may be terminated at any time after 5 years from the date on which the Convention enters into force. If notice of termination is given, the provisions of the Convention with respect to withholding at source will cease to have effect as of January 1 next following the date that is 6 months after the date of delivery of notice of termination. For other taxes, the Convention will cease to have effect as of taxable periods, in the United States, and

income years, in Bangladesh, beginning on or after the date that is 6 months after the date of delivery of notice of termination.

Article 29 relates only to unilateral termination of the Convention by a Contracting State. Nothing in that Article should be construed as preventing the Contracting States from concluding a new bilateral agreement, subject to ratification, that supersedes, amends or terminates provisions of the Convention without the 5-year waiting period or the six-month notification period.

Customary international law observed by the United States and other countries, as reflected in the Vienna Convention on Treaties, allows termination by one Contracting State at any time in the event of a “material breach” of the agreement by the other Contracting State.