TECHNICAL EXPLANATION OF THE CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE REPUBLIC OF THE PHILIPPINES FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME SIGNED AT MANILA ON OCTOBER 1, 1976

Article 1. TAXES COVERED

Paragraph (1) designates the taxes of the Contracting States which are subject to the Convention with respect to the United States, the subject taxes are the Federal income taxes imposed by the Internal Revenue Code ("Code"), but not including sections 531 (accumulated earnings tax) and 541 (personal holding company tax). The Convention only applies to taxes on income contained in the Internal Revenue Code. Thus, the Convention does not, for example, apply to the excise tax under Code section 1491. Also the Convention does not apply to U.S. social security taxes and the Federal unemployment tax.

In the case of the Philippines, paragraph (1) provides that the Convention applies to the income tax imposed by Title II of the National Internal Revenue Code ("Philippine Code"), but not including taxes imposed under sections 25 (additional tax on improperly accumulated earnings) and 63 (personal holding company tax).

Pursuant to paragraph (2), the Convention will also apply to taxes substantially similar to those covered by paragraph (1) which are imposed in addition to, or in place of, existing income taxes, after October 1, 1976, (the date of signature of the Convention).

Paragraph (3) provides that the competent authority of each Contracting State will notify the competent authority of the other Contracting State of any amendment of the tax laws referred to in paragraph (1) or (2), and of the adoption of substantially similar taxes imposed in addition to, or in place of, the taxes referred to in paragraph (1), by transmitting the texts of such amendments or statutes at least once a year. Paragraph (4) provides for a similar annual exchange with respect to the publication of material concerning the application of the Convention, whether in the form of regulations, rulings or judicial decisions.

Article 2. GENERAL DEFINITIONS

Paragraph (1) sets out definitions of certain basic terms used in the Convention. Unless the context otherwise requires, the terms defined in this paragraph have a uniform meaning throughout the Convention.

It should be noted that a number of important terms are defined elsewhere in the Convention.

The term "United States" means the United States of America. When used in the geographical sense, the term means the states of the United States and the District of Columbia. Thus, the Convention does not apply to the possessions of the United States or the Commonwealth of Puerto Rico. The term "United States" also includes the territorial sea and, as provided in section 638 of the Code, the continental shelf of the United States. The term "Philippines" means the Republic of the Philippines. When used in a geographical sense, the term means the territory comprising the Republic of the Philippines.

The term "Contracting State" is defined to mean the United States or the Philippines as the context requires.

The term "person" includes an individual, a partnership, or corporation, an estate or a trust.

The term "United States corporation" is defined as a corporation, or any unincorporated entity which is treated as a corporation for United States tax purposes, which is created or organized in or under the laws of the United States, any state thereof, or the District of Columbia. A "Philippine corporation" is defined as a corporation, or any unincorporated entity which is treated as a corporation for Philippine tax purposes, which is created or organized in the Philippines or under its laws. Under section 84(b) of the Philippine Code, the term "corporation" includes partnerships, no matter how created or organized, other than general professional partnerships. A general professional partnership is formed for the sole purpose of exercising a common profession, no part of the income of which is derived from engaging in a trade or business. Thus, a partnership formed in the United States which is engaged in a trade or business in the Philippines is considered to be a corporation for Philippine tax purposes. Nonetheless, for purposes of the Treaty, that partnership will not be considered to be a Philippine corporation within the meaning of paragraph (1)(e)(ii) since it was not created or organized in or under the laws of the Philippines.

With respect to the United States, the term "competent authority" means the Secretary of the Treasury or his delegate. With respect to the Philippines, it means the Secretary of Finance or his delegate. The term "tax" means those taxes imposed by the United States or the Philippines to which the Convention applies by virtue of Article 1 (Taxes Covered). However, as provided in paragraph (4) of Article 24 (Nondiscrimination), the term "taxes" or "taxation" means, for purposes of that article, taxes or taxation of every kind imposed at the national, state, or local level.

The term "international traffic" is defined as any transport by a ship or aircraft operated by a resident of one of the Contracting States except where such transport is confined solely between places within a Contracting

State. Thus, for example, coastal shipping along the Atlantic coast of the United States is not international traffic. However, if a ship operated by a resident of the Philippines transports goods from Canada to the United States, leaving some of the goods in San Francisco and the remainder in San Diego, the portion of the voyage between San Francisco and San Diego is international traffic.

Paragraph (2) provides that any term used in the Convention which is not defined therein shall, unless the context otherwise requires, have the meaning which it has under the laws of the Contracting State whose tax is being determined. However, where a term has a different meaning under the laws of the Philippines and the United States or where the meaning under the laws of one of the Contracting States is not readily determinable, the competent authorities may for purposes of the Convention establish a common meaning in order to prevent double taxation or to further any other purpose of the Convention.

Article 3. FISCAL RESIDENCE

This Article sets forth rules for determining the residence of individuals, corporations, and other persons for purposes of the Convention. Residence is important because, in general, only a resident of one of the Contracting States may qualify for the benefits of the Convention.

Under paragraph (1), the term "resident of the Philippines" means a Philippine corporation (as defined in Article 2 (General Definitions)) or any other person (except a corporation or any entity treated as a corporation for Philippine tax purposes) resident in the Philippines for purposes of Philippine tax. Thus, for example, a partnership formed in the United States which engages in a trade or business in the Philippines and is treated as a corporation under Philippine tax law is not a resident of the Philippines. It does not meet the condition of paragraph (1)(a)(i) since it is not a Philippine corporation as defined in Article 2 and it does not meet the condition of paragraph 1(a)(ii) since it is an entity treated as a corporation for Philippine tax purposes. Under paragraph (1) of Article 6 (General Rules of Taxation), such a partnership may be taxed by the Philippines only on income from sources therein, to the extent the partnership is treated as a resident of the United States under paragraph (1)(b)(ii). Similarly "resident of the United States" means a United States corporation (as defined in Article 2) and any other person (except a corporation or any entity treated as a corporation for United States tax purposes) resident in the United States for purposes of United States tax. Thus, a resident of the United States includes a resident alien individual who is subject to tax in the United States on his worldwide income and a resident citizen, but under no circumstances, a foreign corporation.

A citizen of the United States or the Philippines is not automatically a resident of the United States or the Philippines for purposes of this Convention. An individual's residence is determined on the basis of whether the individual is treated as a resident for tax purposes by a

Contracting State. An individual who is a resident of both Contracting States will be deemed to be a resident of the Contracting State in which he has his permanent home, his center of vital interests (closest personal and economic relations), a habitual abode, or his citizenship, in the order listed. If the issue is not settled by these tests, the competent authorities will decide by mutual agreement the one Contracting State of which he will be considered to be a resident.

The Convention provides that a partnership, estate or trust, in the case of the United States, and a professional partnership, estate, or trust, in the case of the Philippines, is a resident of the applicable Contracting State only to the extent that the income derived by such person is subject to tax in such Contracting State as the income of a resident. For example, under United States law, a partnership is never, and an estate or trust is often not, taxed as such. Under the Convention, in the case of the United States income received by a partnership, estate, or trust will not qualify for the benefits of the Convention unless such income is subject to tax in the United States as the income of a resident. Thus, for United States tax purposes, the treatment of income received by a partnership will be determined by the residence and taxation of its partners with respect to that income rather than by whether the partnership is resident in the United States by engaging in a trade or business here. To the extent the income of the partners is subject to United States tax as the income of residents of the United States, the partnership will be treated as a resident of the United States. Similarly, the treatment of income received by a trust or estate will be determined by the residence and taxation of the person subject to tax on such income, which may be the grantor, the beneficiaries or the trust or estate itself, as the case may be.

The fact that a charitable trust or pension fund is exempt from tax in the country in which it is otherwise resident is not to be construed to deny such exempt trust or fund resident status under this Convention.

Article 4. SOURCE OF INCOME

This Article contains the source rules which are to be used in applying the provisions of the Convention. For example, under Article 6 (General Rules of Taxation), one Contracting State may tax a resident of the other Contracting State only on income from sources within the first-mentioned Contracting State (provided such resident is not a citizen of the first-mentioned Contracting State).

Paragraph (1) provides that, as a general rule, dividends will be treated as income from sources within a Contracting State if paid by a corporation of that Contracting State or if paid by a corporation of any State, provided that, in the latter case, at least 50 percent of such corporation's gross income from all sources for the 3-year period (or such part of that period as the corporation has been in existence) ending with the close of its taxable year preceding the declaration of the dividends was business profits attributable to a permanent establishment which such corporation had in that Contracting State. In such a case, only a

pro rata portion of the dividend will be treated as income from sources within the applicable Contracting State. Such portion is the amount which bears the same ratio to the dividends as the amount of the business profits attributable to the permanent establishment bears to the corporation's gross income. If a dividend would be treated under paragraph (1) as income from sources within both Contracting States, the pro rata portion of the dividend which is deemed to be from sources within the Contracting State in which the permanent establishment is situated is considered to be from sources only within that Contracting State. The remaining portion of the dividend, if any, shall be considered to be from sources within the other State.

A counterpart to the dividend source rule of the Convention appears in Code section 861(a)(2)(B). However, under Code section 864(c)(4), only four types of income from sources outside the United States -- certain rents, royalties, or gains on sales of intangible property; certain dividends or interest, or gains or losses from sales of securities in connection with certain banking, financing and security trading businesses; certain sales of goods or merchandise through an office in the United States; and, certain income received by foreign life insurance companies -- can be considered to be effectively connected with the conduct of a trade or business within the United States. If, for example, the business profits of a permanent establishment maintained by a Philippine corporation is comprised entirely of income from sources outside the United States not specified in Code section 864(c)(4), the United States will not tax a dividend paid by the Philippine corporation even if more than 50 percent of that corporation's gross income is attributable to the permanent establishment. The United States foregoes its right to tax in such circumstances. Under paragraph (2) of Article 6 (General Rules of Taxation), the Convention will not increase a person's United States tax.

Under paragraph (2) of Article 4, interest will be treated as income from sources within a Contracting State only if paid by the Contracting State, a political subdivision or local authority thereof, or by a resident of that Contracting State. The one exception to this rule is that if interest is paid on an indebtedness incurred in connection with a permanent establishment which bears such interest, then such interest shall be deemed to be from sources within the State (whether or not a Contracting State) in which the permanent establishment is situated. This exception permits a Contracting State, under the proper circumstances, to impose a tax on interest borne by a permanent establishment therein, including a permanent establishment of a resident of a State other than a Contracting State. For example, if a resident of France has a permanent establishment in the Philippines which borrows money from a resident of the United States and bears the interest, the interest will be deemed to be from sources within the Philippines. However, the United States will not, because of Article 6 (General Rules of Taxation) and Code section 861 (a)(1)(C) and (D), impose a tax on interest received by nonresident alien individuals or foreign corporations from a foreign corporation having a permanent establishment in the United States unless 50 percent

or more of the gross income of such corporation from all sources for the 3-year period ending with the close of its taxable year preceding the the payment of the interest (or such part of such period as the corporation has been in existence) was effectively connected with the conduct of a trade or business within the United States. Even where the United States imposes a tax, no tax will be imposed on the portion of such interest which bears the same ratio to the total amount of the interest as the gross income of the corporation which was not effectively connected with the conduct of a trade or business in the United States bears to that corporation's gross income from all sources.

In addition, the permanent establishment exception to the general source rule for interest will exempt interest from tax in the Contracting State in which the payor resides if the payor has a permanent establishment in a State other than a Contracting State in connection with which the indebtedness of which the interest is paid was incurred, such interest is borne by the permanent establishment and such interest is paid to a resident of the other Contracting State. This results, once again, from the restriction in paragraph (1) of Article 6 (General Rules of Taxation) that a resident of one Contracting State, not a citizen of the other Contracting State, may be taxed by the other Contracting State only on income from sources within that other Contracting State. For example, if a resident of the United States has a permanent establishment in France which borrows money from a resident of the Philippines and bears the interest, the interest will be deemed to be from French sources, even if paid by the United States resident. Thus, the United States may not tax such income unless the recipient-resident of the Philippines is a citizen of the United States or has a permanent establishment in the U.S. to which the income is attributable. The rules of Article 5 (Permanent Establishment) will be applied to determine whether the resident of the United States has a permanent establishment in France.

Paragraph (3) provides that royalties for the use of, or the right to use, property or rights will be treated as income from sources within a Contracting State only to the extent that such royalties are for the use of, or the right to use, such property or rights within that Contracting State. However, if a royalty is paid with respect to a liability to pay the royalty that was incurred in connection with a permanent establishment which bears that royalty, then such royalty shall be deemed to be from sources within the State (whether or not a Contracting State) in which the permanent establishment is situated. It is intended that such exception will be applied in a manner similar to the exception with respect to interest. However, the United States will not, because of Code sections 861(a)(4) and 862(a)(4), impose a tax on royalties received by nonresident aliens or foreign corporations from a foreign corporation having a permanent establishment in the United States except to the extent that the royalties are for the use of, or the privilege of using, the property in the United States or the recipient of the royalties is engaged in the active conduct of a business in the United States so that Code section 864(c)(4)(B)(i) applies.

Paragraph (4) provides that income (including royalties) to which Article 7 (Income from Real Property) applies will be treated as income from sources within a Contracting State only if the real property is situated in that Contracting State.

. Under paragraph (5), income received by an individual for his performance of labor or personal services, whether as an employee or in an independent capacity, will be treated as income from sources within a Contracting State only to the extent that such services are performed in that Contracting State. However, income from personal services performed aboard ships or aircraft operated by a resident of a Contracting State in international traffic will be treated as income from sources within that Contracting State if rendered by a member of the regular complement of that ship or aircraft. Notwithstanding the general rule and the above described exception, remuneration described in Article 20 (Governmental Functions) and payments described in Article 19 (Social Security Payments) paid from the public funds of a Contracting State or a political subdivision or local authority thereof will be treated as income from sources within that Contracting State only.

Paragraph (6) contains a general qualification to the preceding source rules. It provides that business profits attributable to a permanent establishment which the recipient, a resident of one Contracting State, has in the other Contracting State will be treated as income from sources within that other Contracting State. Business profits attributable to such permanent establishment may include any item of income described in paragraphs (1) through (4) if the item of income is effectively connected with the permanent establishment. See the discussion of paragraph (6) of Article 8 (Business Profits) for a discussion of the "effectively connected" concept.

Under paragraph (7), gross revenues from the operation of ships or aircraft in international traffic will be treated as from sources within a Contracting State to the extent the revenues are derived from outgoing traffic originating in that State. Thus, for example, gross revenues derived from transporting passengers and freight from Manila to Hawaii, non-stop aboard an airplane, are deemed to be derived from sources within the Philippines for purposes of the Convention.

Under paragraph (8), the source of any item of income not described in the preceding paragraphs of Article 4 will be determined by each Contracting State in accordance with its own law. However, if the source of any such item of income under the laws of one Contracting State is different from its source under the laws of the other Contracting State or if its source is not readily determinable under the laws of one of the Contracting States, the competent authorities of the Contracting States may, in order to prevent double taxation or further any other purpose of the Convention, establish a common source of the item of income for purposes of the Convention.

As mentioned previously, several of the source rules set out in this Article differ to some degree from those provided in the Code. Since paragraph (2) of Article 6 (General Rules of Taxation) provides that the Convention will not increase a person's United States tax, a taxpayer is entitled to use the more beneficial of the Code rules or the Convention rules in calculating his United States tax.

Article 5. PERMANENT ESTABLISHMENT

This Article defines the term "permanent establishment." The existence of a permanent establishment is relevant under Article 8 (Business Profits) to the taxation of business profits and in determining the applicability of other provisions of the Convention.

Under paragraph (1), the term "permanent establishment" means a fixed place of business through which a resident of one of the Contracting States engages in a trade or business. Illustrations in paragraph (2) of a permanent establishment include a seat of management; a branch; an office; a store or other sales outlet; a factory; a workshop; a warehouse; a mine, quarry or other place of extraction of natural resources; a building site or construction or assembly project or supervisory activities in connection therewith, provided the site, project, or activity continues for a period of more than 183 days; and, the furnishing of services, including consultancy services, by a resident of one Contracting State through employees or other personnel, provided activities of that nature continue (for the same or a connected project) within the other Contracting State for a period or periods aggregating more than 183 days. Under the building site or construction or assembly project or supervisory activities rule, the 183-day period begins only when work physically commences in the other Contracting State. For purposes of that rule, a series of contracts or projects which are interdependent both commercially and geographically is to be treated as a single project when applying the 183-day test. In that respect, it is similar to the furnishing services rule.

As a general rule, any fixed facility or premises through which a resident engages in a trade or business for an indefinite or substantial period of time will be treated as a permanent establishment unless it is used only for one or more of the activities described in paragraph (3). Paragraph (3) specifically provides that a permanent establishment does not include a fixed place of business if it is used only for one or more of the following:

(a) The use of facilities solely for the purpose of storage, display, or occasional delivery of goods or merchandise belonging to the resident;

(b) The maintenance of a stock of goods or merchandise belonging to the resident solely for the purpose of storage, display, or occasional delivery;

(c) The maintenance of a stock of goods or merchandise belonging to the resident solely for the purpose of processing by another person;

(d) The maintenance of a fixed place of business for the purpose of purchasing goods or merchandise, or for collecting information, for the resident;

(e) The maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research, or for similar activities which have a preparatory or auxiliary character, for the resident; or

(f) The furnishing of ser[illegible]es, including the provision of equipment, in one of the Contrac[illegible] States by a resident of the other Contracting State, including consultancy firms, in accordance with, or in the implementation of, an agreement between the Contracting States regarding technical cooperation. Such an agreement was signed at Manila on April 27, 1951. See Economic and Technical Cooperation Agreement with the Philippines, April 27, 1951, [1952] 3 U.S.T. 3707, T.I.A.S. 2498.

As noted, these exceptions are cumulative and a fixed place of business used only for one or more of these purposes will not be considered a permanent establishment under the Convention. It is intended that a building site or construction or assembly project or supervisory activities in connection therewith which does not exist for more than 183 days does not constitute a permanent establishment.

Under paragraph (4), a person acting in one Contracting State on behalf of a resident of the other Contracting State, other than an agent of an independent status to whom paragraph (5) applies, will be deemed to constitute a permanent establishment if such person has, and habitually exercises in that first-mentioned Contracting State, an authority to conclude contracts in the name of the resident, unless the exercise of the authority is limited to the purchase of goods or merchandise for the resident. Even if the person has no authority to conclude contracts in the name of the resident, he will be deemed to constitute a permanent establishment if he habitually maintains in the first-mentioned Contracting State a stock of goods or merchandise from which he regularly delivers goods and merchandise on behalf of the resident. Similar rules appear in Code section 864(c)(5)(A).

On the other hand, paragraph (5) provides that a resident of one Contracting State will not be deemed to have a permanent establishment in the other Contracting State merely because such resident carries on business in such other Contracting State through a broker, general commission agent, or any other agent of an independent status, where such broker or agent is acting in the ordinary course of his business.

However, if the activities of the agent are devoted wholly or almost wholly on behalf of that resident and the transactions between the agent and the resident are not made under arm's length conditions, the agent will not be considered to be an agent of independent status within the meaning of paragraph (5). Thus, for example, an agent will not lose his status as an independent agent merely because he acts exclusively or almost exclusively for a resident of the other Contracting State. Nor will an agent lose his status as an independent agent merely because he enters into transactions with the resident under non-arm's length conditions. However, where both such conditions exist, the agent, in effect, is no longer independent and paragraph (5) reflects that fact. Similar rules apply under Code section 864 (c)(5)(A)(ii). Regulations section 1.864-7(d)(3)(iii) indicates that an otherwise independent agent who acts exclusively or almost exclusively for one foreign principal may not be considered to be an agent of independent status in appropriate circumstances.

Paragraph (6) provides that, except with respect to reinsurance, a resident of a Contracting State will be deemed to have a permanent establishment in the other Contracting State if it collects premiums in that other Contracting State, or insures risks situated therein, through an employee or representative situated therein who is not an agent of independent status to whom paragraph (5) applies. A similar provision appears in the existing United States Convention with France.

Paragraph (7) provides that a resident of one Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because such resident sells at the termination of a trade fair or convention in the other Contracting State goods or merchandise which were displayed by such resident at that trade fair or convention. The trade fair exception is not intended to apply with respect to other goods in the resident's inventory. This exception appears in recent United States conventions.

Under paragraph (8), the fact that a corporation of one of the Contracting States controls or is controlled by or is under common control with a corporation of the other Contracting State or a corporation which carries on business in that other Contracting State (whether through a permanent establishment or otherwise) will not be taken into account in determining whether the activities or fixed place of business of either corporation constitutes a permanent establishment of the other corporation.

Paragraph (9) provides that the principles set forth in this Article are to be applied in determining whether there is a permanent establishment in a State other than one of the Contracting States or whether a person other than a resident of one of the Contracting States has a permanent establishment in one of the Contracting States. This is necessary for the proper application of paragraphs (2) and (3) of Article 4 (Source of Income). This paragraph is not intended to extend the benefits of the Convention to persons other than residents of the two Contracting States.

Article 6. GENERAL RULES OF TAXATION

Under paragraph (1), a resident of one Contracting State may be taxed by the other Contracting State on any income from souces within that other Contracting State and only on such income, subject to the limitations set forth in the Convention. For this purpose, the source rules contained in Article 4 (Source of Income) are to be applied. However, if the resident is a citizen of the other Contracting State, that Contracting State may tax the resident without regard to this paragraph because of the saving clause of paragraph (3).

Paragraph (2) contains the customary rule that the Convention will not restrict in any manner any exclusion, exemption, deduction, credit, or other allowance now or hereafter accorded by the laws of a Contracting State in the determination of tax imposed by it, or by any other agreement between the Contracting States. This rule reflects the principle that a convention should not increase the tax burden on residents of the Contracting States.

Paragraph (3) contains the traditional saving clause under which the United States reserves the right to tax its citizens and residents as if the Convention had not come into effect. However, because of paragraph (4), the saving clause does not apply in several cases in which its application would contravene policies reflected in the Convention which are specifically designed to extend treaty benefits to citizens or residents. Thus, the saving clause does not affect the provisions with respect to social security payments, relief from double taxation, nondiscrimination, or the mutual agreement procedure. Moreover, the saving clause does not affect the benefits of the Convention which are conferred upon individuals performing governmental functions, teachers, students, trainees, and diplomatic or consular officers who are neither citizens of, nor have immigrant status in, the Contracting State conferring such benefits. In the case of the United States, "immigrant status" means the individual has been admitted to the United States for permanent residence. The saving clause is reciprocal.

Paragraph (5) authorizes the competent authorities of the Contracting States to prescribe regulations necessary to carry out the provisions of the Convention. On the United States side, this authority is also provided by Code section 7805.

Article 7. INCOME FROM REAL PROPERTY

Under paragraph (1), income from real property, including royalties and other payments in respect of the exploitation of natural resources (e.g., oil wells), and gains from the alienation (sale, exchange or other disposition) of such property or of the right giving rise to such royalties or other payments may be taxed by the Contracting State in which the real property

or natural resources are situated. For purposes of the Convention, interest on indebtedness secured by real property (e.g., mortgages) or secured by a right giving rise to royalties or other payments in respect of the exploitation of natural resources are not considered as income from real property.

Under paragraph (2), paragraph (1) applies to income derived from the usufruct, direct use, letting, or use in any other form of real property.

Article 8. BUSINESS PROFITS

Paragraph (1) sets forth the general rule that business profits of a resident of one Contracting State are exempt from tax by the other Contracting State unless the resident has a permanent establishment in the other Contracting State. Where there is a permanent establishment, only the business profits attributable to the permanent establishment can be taxed by that other Contracting State, unless the resident is a citizen of that other Contracting State. (See the saving clause in paragraph (3) of Article 6 (General Rules of Taxation).) Under paragraph (6) of Article 4 (Source of Income), business profits whether from sources within or without a Contracting State attributable to a permanent establishment which a resident of one Contracting State has in the other Contracting State will be considered to be from sources within that other Contracting State. Thus, items of income described in section 864(c)(4)(B) of the Code attributable to a permanent establishment situated in the United States will be subject to tax by the United States.

In determining the proper attribution of business profits under the Convention, paragraph (2) provides that both Contracting States will attribute to the permanent establishment such profits as it would reasonably be expected to derive if it were an independent entity engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the resident of which it is a permanent establishment. Paragraph (3) embellishes on that rule by providing that business profits derived from the sale of goods or merchandise of the same or similar kind as those sold, or from other business activities of the same or similar kind as those effected, through that permanent establishment, may be attributed to that permanent establishment if the sale or activities had been resorted to in order to avoid taxation.

Under paragraph (4), expenses, wherever incurred, which are reasonably allocable to business profits attributable to the permanent establishment, including executive and general administrative expenses, will be allowed as deductions in determining the business profits of the permanent establishment. However, in determining the amount of the deduction under paragraph (4) for expenses incurred by the head office, the deduction may be limited to the expense incurred without including the profit element for the head office. Moreover, no deductions will be allowed in respect of amounts paid or payable (other than reimbursement

of actual expenses) by the permanent establishment to any office of the resident by way of roya[illegible]s, fees, or other similar payments in return for the use of patents or other rights; commissions for specific services performed or for management; and, except for banking institutions, interest on money lent to the permanent establishment.

Paragraph (5) provides that no profits shall be attributed to a permanent establishment merely because of the purchase of goods or merchandise by that permanent establishment for the account of such resident of which it is a permanent establishment. Paragraph (2) does not override paragraph (5). Thus, where a permanent establishment purchases goods for its head office, the business profits attributed under paragraph (2) to the permanent establishment with respect to its other activities will not be increased by adding a notional figure for profits from purchasing.

Under paragraph (6), the term "business profits" means income derived from any trade or business whether carried on by an individual, corporation, or any other person, or group of persons, including the rental of tangible personal (movable) property. The term "business profits" also includes income from dividends, interest, and royalties, but only if the income is effectively connected with a permanent establishment. See paragraph (4) of Article 11 (Dividends), paragraph (5) of Article 12 (Interest) and paragraph (4) of Article 13 (Royalties).

The Convention contains no criteria for determining whether income is effectively connected with a permanent establishment. However, the "effectively connected" concept in the Convention is substantially similar to the "effectively connected" concept in section 864(c) of the Code. It is intended that the factors which apply under that Code section will apply with respect to this Convention.

Under paragraph (7), where business profits include items of income which are dealt with separately in other articles of the Convention, the provisions of those articles will not be affected by the provisions of this Article. Thus, for example, taxation of interest income will be controlled by Article 12 (Interest) and not by this Article. If the interest is effectively connected with a permanent establishment, paragraph (5) of Article 12 provides that this Article will apply.

Article 9. SHIPPING AND AIR TRANSPORT

Article 9 permits a Contracting State to impose a tax on the profits derived from sources therein by a resident of the other Contracting State from the operation of ships or aircraft in international traffic. In so providing, it departs from the shipping and air transport article which customarily appears in income tax conventions of the United States.

Under paragraph (1), profits derived by a resident of one Contracting State from sources within the other Contracting State from the operation of ships in international traffic may be taxed by both Contracting States. However, a limitation is placed on the amount of tax which may be imposed by the country of source. The tax imposed by the country of source, the "other Contracting State," may be as much as, but shall not exceed 1.5 percent of the gross revenues derived from sources in that State (as determined under paragraph (7) of Article 4 (Source of Income)) or the lowest rate of Philippine tax that may be imposed on profits of the same kind derived under similar circumstances by a resident of a third State, whichever is less. Under that formula, for example, a Philippine corporation which operates ships between Manila and Hawaii and which engages in no other trade or business will determine its United States income tax in the following manner. First, it will compute a tentative tax under Code section 882 on the taxable income which is effectively connected with the conduct of its trade or business within the United States, using the source rule which appears in Code section 863. Then, it will compute the limitation under paragraph (1) by multiplying its gross revenues from United States sources, using the source rule which appears in paragraph (7) of Article 4 (Source of Income), by 1.5 percent. The lower of those two figures is its United States income tax. The reciprocal exemptions of Code sections 872(b) and 883(a) do not apply to Philippine residents because the Philippines imposes a tax on the earnings of foreign carriers in the amount of 2.5 percent of their gross Philippine billings.

Paragraph (2) states that nothing in the Convention affects the right of a Contracting State to tax, under its domestic laws, profits derived by a resident of the other Contracting State from sources within the first-mentioned Contracting State from the operation of aircraft in international traffic. Thus, although the United States and the Republic of the Philippines have placed a limitation in the Convention on the taxation of income from the operation of ships in international traffic, they have not agreed to such a provision with respect to income derived from the operation of aircraft in international traffic. Such income will be taxed in accordance with the tax legislation of each of the Contracting States.

The tax under paragraphs (1) and (2) may be imposed notwithstanding any other provisions of the Convention, including Article 24 (Nondiscrimination). Under paragraph (2) of Article 24, a permanent establishment which a resident of one Contracting State has in the other Contracting State will not be subject in the other Contracting State to more burdensome taxes than a resident of that other Contracting State carrying on the same activites.

It is possible that, under this Article, United States residents operating ships and aircraft in international traffic may be subject to more burdensome taxation in the Philippines than Philippine corporations. For example, Philippine air carriers, other than Philippine Air Lines, and shipping companies enjoy recurring 10-year exemptions from Philippine income tax on income derived from international traffic. Philippine

Air Lines is subject to a franchise tax of 2 percent of gross income in lieu of all Philippine taxes. Should the President find that, with respect to profits from the operation of ships or aircraft in international traffic, United States citizens or corporations are being subjected to a higher effective rate of Philippine tax than are Philippine citizens, residents, or corporations, Articles 9 and 24 do not prevent the adjustment of United States income tax under Code section 896.

Paragraph (3) provides that paragraphs (1) and (2) apply to profits derived from the participation in a pool, a joint business venture, or in an international operating agency.

This Article is subject to the saving clause of paragraph (3) of Article 6 (General Rules of Taxation). Therefore, a Contracting State may tax income from international traffic derived by a resident of the other Contracting State without regard to this Article if such resident is a citizen of the first-mentioned Contracting State.

Article 10. RELATED PERSONS

This Article confirms the authority of the United States under section 482 of the Code. Thus, where a person subject to the taxing jurisdiction of a Contracting State (whether or not a resident thereof) and any other related person make arrangements or impose conditions between themselves which are different from those which would be made between independent persons, under paragraph (1), any income, deductions, credits or allowances which would, but for those arrangements or conditions, have been taken into account in computing the income or loss of, or the tax payable by, one of such persons, may be taken into account in computing the amount of the income subject to tax and the taxes payable by such person in that Contracting State.

Paragraph (2) sets forth an explicit formulation of the consequence of a redetermination made in accordance with paragraph (1) by a Contracting State to the income of one of its residents. In such event, the other Contracting State will, if it agrees with such redetermination and if necessary to prevent double taxation, make a corresponding adjustment to the income of a person in such other Contracting State related to such resident. In the case of the United States, any refunds of tax in respect of such an adjustment shall be made notwithstanding the statute of limitations. In situations where the other Contracting State disagrees with the redetermination, the two Contracting States will endeavor to reach agreement in accordance with the mutual agreement procedure in paragraph (2) of Article 25 (Mutual Agreement Procedure). For a discussion of the mutual agreement procedure and a fuller explanation of the operation of the statute of limitations with respect to adjustments see the discussion under Article 25.

Paragraph (3) provides that for purposes of the Convention a person is related to another person if either person owns or controls directly or indirectly the other, or if a third person or persons own or control directly or indirectly both. "Control" includes any kind of control, whether or not legally enforceable, and however exercised or exercisable.

Article 11. DIVIDENDS

Paragraph (1) provides that dividends derived from sources within one Contracting State by a resident of the other Contracting State may be taxed by both Contracting States. However, paragraph (2) limits the rate of tax imposed by the Contracting State of source to a rate not in excess of 25 percent of the gross amount of the dividends. If the dividend recipient is a corporation, the rate of tax imposed by the Contracting State of source may not exceed 20 percent of the gross amount of the dividend if during the part of the paying corporation's taxable year which precedes the date of payment of the dividend and during the whole of its prior taxable year (if any), at least 10 percent of the outstanding voting stock of the paying corporation was owned by the recipient corporation. These rate limitations do not affect the taxation of profits of the corporation which pays the dividends.

Paragraph (3) provides that dividends paid by a corporation of one of the Contracting States to a person other than a citizen or resident of the other Contracting State may be taxed by that other Contracting State only in limited circumstances. Such other Contracting State may impose tax if the dividends are treated as income from sources in that State under paragraph (1)(b) of Article 4 (Source of Income), but only on the portion of the dividend which is deemed to be income from sources within the other Contracting State. Moreover, the Philippines may only tax such a dividend if the Philippine branch profits tax described in paragraph (6) has not been paid with respect to the earnings distributed. In addition, the other Contracting State may impose tax if the recipient of the dividend has a permanent establishment or a fixed base in the State and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment or fixed base.

Paragraph (4) provides that the limitations of paragraph (2) shall not apply if the recipient of the dividends derived from sources within a Contracting State, being a resident of the other Contracting State, carries on business in the first-mentioned Contracting State through a permanent establishment situated therein or performs in that other State independent personal services from a fixed base situated therein, and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment or fixed base. In such a case, the dividends shall be treated as business profits subject to the provisions of Article 8 (Business Profits) or income from the performance of independent personal services subject to the provisions of

Article 15 (Independent Personal Services), as the case may be. If the recipient of the dividend is a citizen or resident of the source Contracting State, that Contracting State may tax the recipient without regard to this Article because of the saving clause of paragraph (3) of Article 6 (General Rules of Taxation).

Paragraph (5) provides that the term "dividends" as used in the Convention means income from shares, mining shares, founders' shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights assimilated to income from shares by the taxation law of the State of which the corporation making the distribution is a resident.

Paragraph (6) relates to the Philippine branch profits tax. Under section 24(b)(2) of the Philippine Code, the Philippines imposes a tax of 20 percent upon profits which are remitted outside the Philippines by a Philippine branch office to its mother company. Paragraph (6) preserves the right of the Philippines to impose such a branch profits tax by providing that nothing in the Convention will be construed to prevent the Philippines from imposing on the earnings of a corporation (other than a Philippine corporation) attributable to a permanent establishment in the Philippines, a tax in addition to the tax which would be chargeable on the earnings of a Philippine corporation. Such Philippine branch profits tax will not exceed 20 percent of the amount of such earnings which have not been subjected to such additional tax in previous taxable years, and in accordance with Philippine law, will only be imposed when such earnings are remitted outside the Philippines. The term "earnings" means, for purposes of paragraph (6), business profits attributable to a permanent establishment for the year in issue and all previous years after deducting therefrom all Philippine tax imposed thereon other than the Philippine branch profits tax.

Article 12. INTEREST

Paragraph (1) provides that interest derived by a resident of one Contracting State may be taxed by both Contracting States. However, the rate of tax in the Contracting State of source is limited by paragraph (2) to a rate not in excess of 15 percent of the gross amount of the interest and, if the interest is derived with respect to public issues of bonded indebtedness, by paragraph (3) to a rate not in excess of 10 percent of the gross amount of the interest.

Paragraph (4) provides that interest beneficially derived by one of the Contracting States, or by an instrumentality of that Contracting State, will be exempt from tax by the other Contracting State. Under this rule, interest income derived by the Central Bank of the Philippines, the Federal Reserve Banks of the United States, the Export-Import Bank of the United States, the Overseas Private Investment Corporation (OPIC),

and such other institutions of either Contracting State as the competent authorities may determine by mutual agreement on loans made to residents of the other Contracting State will be exempt from tax in that other State. The exemption also applies where a resident of a Contracting State receives interest income with respect to debt obligations guaranteed or insured by that Contracting State or an instrumentality thereof.

Paragraph (5) provides that the reduced rate of tax under paragraphs (2) and (3) and the exemption under paragraph (4) will not apply if the recipient of interest from sources within one Contracting State, being a resident of the other Contracting State carries on business through a permanent establishment situated therein or performs in that other State independent personal services from a fixed base situated therein and the debt claim in respect of which the interest is paid is effectively connected with such permanent establishment or fixed base. In such a case, the interest will be treated as business profits subject to the provisions of Article 8 (Business Profits) or income from the performance of independent personal services subject to the provisions of Article 15 (Independent Personal Services), as the case may be.

If excessive interest is paid to a related person, paragraph (6) provides that this Article does not apply to the excessive portion of the payment. The excessive portion may be taxed by each Contracting State according to its own laws, including the Convention where applicable. In the case of the United States, the excessive portion may be taxed as a dividend, in which case the provisions of Article 11 (Dividends) will apply.

Paragraph (7) defines interest for purposes of the Convention as income from debt-claims of every kind, whether or not secured by mortgage, and whether or not carrying a right to participate in the debtor's profits. In particular, the term "interest" includes income from government securities and income from bonds or debentures, including premiums and prizes attached to such bonds, debentures or government securities and other income (such as original issue discount) which under the taxation laws of the Contracting State in which the income arises is assimilated to income from money lent.

This Article is subject to the saving clause of paragraph (3) of Article 6 (General Rules of Taxation). Therefore, interest derived by a citizen or resident of the source Contracting State may be taxed by that Contracting State without regard to this Article.

Article 13. ROYALTIES

Paragraph (1) provides that royalties derived by a resident of one Contracting State from sources within the other Contracting State may be taxed by both Contracting States. However, the rate of tax imposed by that other Contracting State on such royalties is limited under paragraph (2). If the royalties are derived from sources within the United States,

the United States tax is limited to a rate which does not exceed 15 percent of the gross amount of those royalties. On the other hand, if the royalties are derived from sources within the Philippines, the tax is subject to three limitations. In general, the Philippine tax is limited to a rate which does not exceed 25 percent of the gross amount of the royalties. However, if the royalties are paid by a corporation registered with the Philippine Board of Investments and engaged in preferred areas of activity, the tax is limited to a rate which does not exceed 15 percent of the gross amount of the royalties. Notwithstanding such 25 percent and 15 percent limitations, the Philippine tax cannot exceed the lowest rate of Philippine tax that may be imposed on royalties of the same kind under similar circumstances to a resident of a third State. Thus, for example, because the Philippines agreed to limit its tax on film royalties to an amount not in excess of 10 percent of the gross amount of such royalties in its Income Tax Conventions with Sweden and Denmark, that limitation will apply to film royalties paid under similar circumstances to United States residents. Of course, if those 10-percent limitations are renegotiated upward by the Philippines the limitation with respect to the tax on United States residents will be affected. However, under paragraph (2) of Article 29 (Entry Into Force), such third-described limitation with respect to the tax on royalties will not have effect with respect to payments for the use of, or the right to use, a copyright of cinematographic films or films or tapes used for radio or television broadcasting until January 1, 1979.

The term "royalties" is defined in paragraph (3) as payments of any kind made as consideration for the use of, or the right to use, any copyright of literary, artistic, or scientific work, including copyrights of cinematographic films or films or tapes used for radio or television broadcasting, any patent, trademark, design, model, plan, secret process or formula, or other like right or property, or information concerning industrial, commercial, or scientific experience (know-how). The term "royalties" also includes gains derived from the sale, exchange, or other disposition of any such right or property which are contingent on the productivity, use, or disposition thereof. If the amounts realized are not so contingent, the provisions of Article 14 (Capital Gains) may apply.

Paragraph (4) provides that the tax rate limitations of paragraph (2) shall not apply if the recipient of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise through a permanent establishment situated therein, or performs in that other State professional services from a fixed base situated therein, and the right or property in respect to which the royalties are paid is effectively connected with such permanent establishment or fixed base. In such case, the royalties will be treated as business profits subject to Article 8 (Business Profits) or income from the performance of independent personal services subject to tax under Article 15 (Independent Personal Services).

If excessive royalties are paid to a related person, paragraph (5) provides that this Article does not apply to the excessive portion of the royalty. The excessive portion may be taxed by each Contracting State according to its own laws, including the Convention where applicable. Thus, in the case of the United States, the excessive portion may be treated as a dividend or interest, or in whatever other manner is appropriate.

This Article is subject to the saving clause of paragraph (3) of Article 6 (General Rules of Taxation). Therefore, royalties derived by a citizen or resident of the source Contracting State may be taxed by that Contracting State without regard to this Article.

Article 14. CAPITAL GAINS

This Article sets forth the circumstances in which gains derived by a resident of one Contracting State may be taxed by the other Contracting State.

Under paragraph (1), gains from the alienation of tangible personal (movable) property forming part of the business property of a permanent establishment which a resident of a Contracting State has in the other Contracting State or gains from the sale of tangible personal (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, including gains from the alienation of the permanent establishment (along or together with the whole enterprise) or the fixed base, may be taxed in that other State. However, gains derived by a resident of a Contracting State from the alienation of ships, aircraft or containers operated by such resident in international traffic will only be subject to tax in the State of the operator's residence, notwithstanding the fact that profits derived by such resident from sources within the other Contracting State from the operation of such ships or aircraft may be taxed by both States under Article 9 (Shipping and Air Transport). Gains which are considered to be royalties under paragraph (3) of Article 13 (Royalties) will only be taxed in accordance with the provisions of Article 13.

Paragraph (2) provides that gains from the alienation of any property other than those mentioned in paragraph (1) or those mentioned in Article 7 (Real Property) will only be taxed in the Contracting State of which the alienator is a resident.

If the recipient of the gain is a resident of one Contracting State and a citizen of the other Contracting State, that other Contracting State may tax the recipient without regard to this Article because of the saving clause of paragraph (3) of Article 6 (General Rules of Taxation).

Article 15. INDEPENDENT PERSONAL SERVICES

In dealing with the taxation of income from personal services, the Convention distinguishes between "independent" and "dependent" personal services. The Convention also provides special treatment with respect to individuals who are public entertainers.

Under paragraph (1), income derived by an individual resident of one Contracting State from the performance of personal services in an independent capacity may be taxed only by that Contracting State. However, under paragraph (2), such income derived from services performed in the other Contracting State may also be taxed in that other Contracting State in certain circumstances. Thus, if the individual has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities, he may be taxed by that State, but only on the income that is attributable to that fixed base (the term fixed base is synonymous with the term "permanent establishment" as described in Article 5 (Permanent Establishment)). Similarly, if the individual is present in the other Contracting State for a period or periods aggregating 90 days or more in the taxable year, he may be taxed by that State. Finally, if the gross remuneration derived in the taxable year from residents of the other Contracting State for the performance of personal services in an individual capacity in that other Contracting State exceeds $10,000 or its equivalent in Philippine pesos that other Contracting State may tax the income of that individual from the performance of those services. Since the $10,000 is gross remuneration, it includes any expenses, such as airfare, borne on behalf of or reimbursed to the individual performing the personal services. Article 15 also provides that the competent authorities may specify in an exchange of letters that the $10,000 limitation will be increased if circumstances warrant, i.e., if inflation reduces the real value of $10,000. Once increased, the limitation can be decreased by the competent authorities, but never to an amount less than $10,000.

Paragraph (3) makes clear that the other Contracting State referred to in paragraph (2) may impose its tax only on net income.

Under the saving clause of paragraph (3) of Article 6 (General Rules of Taxation), the other Contracting State may also tax any individual who is a citizen or resident of that other Contracting State without regard to this Article.

Personal services performed by an individual in an independent capacity are services performed for his own account where he receives the income and bears the losses arising from such services. If an individual is an independent contractor, he is considered to perform personal services in an independent capacity. Income from services in which capital is a material income-producing factor, however, will

generally be governed by the provisions of Article 7 (Business Profits). Generally, the term "personal services in an independent capacity" includes, but is not limited to, services rendered as a director of a corporation or rendered by physicians, lawyers, engineers, architects, dentists, and accountants performing personal services as sole proprietors or partners. Services performed by employees, such as by an officer of a corporation, are dependent personal services to which Article 16 (Dependent Personal Services) applies.

Article 16. DEPENDENT PERSONAL SERVICES

This Article deals with the taxation in respect of dependent personal services. This Article is similar in many respects to Article 15 (Dependent Personal Services) of the OECD Model Convention. Under paragraph (1), wages, salaries, and similar remuneration derived by an individual who is a resident of one Contracting State from labor or personal services performed as an employee, including income from services performed by an officer of a corporation, may be taxed by that Contracting State, except as provided in Article 20 (Governmental Functions). In addition, except as provided by paragraphs (2) and (3) and in Articles 20 (Governmental Functions), 21 (Teachers), and 22 (Students and Trainees), remuneration from the performance of dependent personal services derived from sources within the other Contracting State may be taxed by that other Contracting State.

Under paragraph (2), dependent personal service income derived by an individual resident of one Contracting State will be exempt from tax by the other Contracting State if: (a) the individual is present in that other Contracting State for a period or periods aggregating less than 90 days in the taxable year; (b) the individual is an employee of a resident of the first-mentioned Contracting State or of a permanent establishment maintained in the first-mentioned Contracting State; and (c) the remuneration is not borne as such by a permanent establishment or fixed base which the employer has in the other Contracting State. Such income, however, may also be taxed by that other Contracting State without regard to this Article if the individual is a citizen or resident of that other Contracting State, because of the saving clause of paragraph (3) of Article 6 (General Rules of Taxation).

In the United States, remuneration from the performance of dependent services will be viewed as not having been borne by the permanent establishment or fixed base maintained in the United States if the employee is performing stewardship or overseeing functions for the benefit of a resident of or a permanent establishment maintained in the Philippines. However, the remuneration will be considered to be borne by the permanent establishment or fixed base maintained in the United States if the remuneration is paid for activities other than stewardship or overseeing functions and the permanent establishment or fixed base is entitled to

claim the employee's remuneration as a deduction in computing taxable income for United States purposes because the remuneration is definitely related and allocable to its gross income or a class of its gross income pursuant to Code section 861 and the regulations thereunder.

Paragraph (3) provides that, notwithstanding the provisions of paragraphs (2) and (3), remuneration derived by an employee (even if a resident of a State other than a Contracting State) of a resident of one Contracting State for labor or personal services performed as a member of the regular complement of a ship or aircraft operated in international traffic by a resident of that Contracting State may be taxed only by that Contracting State.

Article 17. ARTISTES AND ATHLETES

This Article deals with the taxation of income derived by public entertainers and athletes (sometimes referred to as "artistes and athletes") in respect of the performance of services as such in a Contracting State. The Article applies in cases where an artiste or athlete performs services on his own behalf and in cases where services are performed on behalf of another person, as an employee or pursuant to any other arrangement.

Paragraph (1) states the general rule that notwithstanding the provisions of Articles 15 (Independent Personal Services) and 16 (Dependent Personal Services), income derived by public entertainers such as theater, motion picture, radio, or television artistes, and musicians, and by athletes, from their personal activities as such, may be taxed in the Contracting State where those activities are exercised. Such income, however, is taxable under this Article only where it exceeds $100 or its equivalent in Philippine pesos per day or exceeds in the aggregate $3,000 or its equivalent in Philippine pesos during the taxable year.

As noted above, this paragraph overrides the provisions of Articles 15 and 16, so that an artiste or athlete may be taxed in the State where his activities take place regardless of the period of time he is present in that State. Generally, however, income derived from services rendered by producers, directors, technicians and others who are not artistes and athletes is taxable in accordance with the provisions of Article 15 or 16, as the case may be.

Paragraph (2) deals with cases where income in respect of the activities of an entertainer or athlete accrues to a person other than, or in addition to, the entertainer or athlete. It is based on paragraph (2) of Article 17 (Artistes and Athletes) of the OECD Model Convention and a counterpart is found in recent United States conventions with the United

Kingdom, Japan, Trinidad and Tobago, and Iceland. A common method employed by foreign entertainers is to perform services in the United States as an employee of or a contractor for a corporation or other person. That person may act as the nominal recipient of the income in respect of the entertainer's services and the entertainer may act as its "employee" or "contractor." In such cases, the corporation may escape taxation in respect of those services by reason of Article 8 (Business Profits) because it does not have a permanent establishment in the United States described under Article 5 (Permanent Establishment). The entertainer may also escape taxation by receiving a small salary while in the United States and by receiving payment in a later year when the income is subject to reduced rates of tax or no tax at all, or by liquidating the corporation after the services are performed.

Paragraph (2) is designed to deal with these situations by providing that where income in respect of the personal activities of an artiste or athlete accrues to the benefit of another person (including a corporation, trust, or partnership of either Contracting State or any third State), that income may, notwithstanding the provisions of Articles 8 (Business Profits), 15 (Independent Personal Services), and 16 (Dependent Personal Services), be taxed in the Contracting State in which the activities of the entertainer or athlete are exercised. Thus, for example, such other person could not claim the permanent establishment protection provided by Articles 5 (Permanent Establishment) and 8 (Business Profits).

For purposes of paragraph (2), income is considered to accrue to the benefit of another person where that other person has control over or the right to gross income derived in respect of an entertainer's or athlete's services as such. This rule applies regardless of whether the other person is a "sham" corporation or conduit. However, income will not be deemed to accrue to the benefit of another person where it is established to the satisfaction of the competent authority of the Contracting State where the services are performed that neither the entertainer or athlete, nor persons related thereto, participate directly or indirectly in the profits of such other person or receive any benefit from such profits. Persons may be considered to be related to the artiste or athlete regardless of whether the persons are considered to be related under the provisions of paragraph (3) of Article 10 (Related Persons). For this purpose, a person may be considered to be related to the artiste or athlete if he is an employee or agent of the artiste or athlete, or if he is regularly employed by the artiste or athlete in an advisory capacity, such as his attorney, accountant, or investment advisor. An artiste or athlete will be considered to participate in the profits of the other person if he received, or is entitled to receive, deferred compensation, bonuses, fees, dividends, partnership or other distributions from that person or the proceeds from the sale or disposition of an interest in that person during the year in which services are performed, or in any subsequent year.

Paragraph (3) provides that, notwithstanding the provisions of paragraph (1) and Articles 15 (Independent Personal Services) and 16 (Dependent Personal Services), income derived from activities performed in a Contracting State by public entertainers or athletes will be exempt from tax in that Contracting State if the visit to that State is substantially supported or sponsored by the other Contracting State and the public entertainer or athlete is certified as qualified under this provision by the competent authority of the sending State. Under this provision, for example, Philippine folk dance troupe performers would be exempt from tax in the United States if their visit is substantially supported or sponsored by the Philippine Government and the Secretary of Finance of the Philippines or his delegate certifies those performers as qualified for exemption.

Article 18. PRIVATE PENSIONS AND ANNUITIES

Except as provided in Article 20 (Governmental Functions), pensions and other similar remuneration paid to an individual will be taxable under paragraph (1) only in the Contracting State where the service is rendered. Thus, private pensions and similar remuneration derived from sources within one Contracting State by an individual resident of the other Contracting State may be taxed in the first-mentioned Contracting State. The term "pensions and other similar remuneration" is defined in paragraph (4) to include any periodic payments, other than payments covered in Article 19 (Social Security Payments), made by reason of retirement or death and in consideration for services rendered, or by way of compensation for injuries or sickness received in connection with past employment. Thus, where payments are considered to be pensions or similar remuneration under the laws of one of the Contracting States, such payments will be considered to be pensions or similar remuneration for purposes of paragraph (1), subject to an agreement to the contrary by the competent authorities acting under paragraph (2) of Article 2 (General Definitions) to prevent double taxation or to further any other purpose of the Convention. Thus, for example, for United States tax purposes, distributions from independent retirement accounts would be considered to be pensions or similar remuneration to which paragraph (1) applies. On the other hand, the term pension does not include, for United States tax purposes, payments in respect of the cancellation or premature termination of employment contracts (e.g., "golden handshakes" or severance pay). Such payments are taxable under the provisions of Articles 15 (Independent Personal Services), 16 (Dependent Personal Services) or 17 (Artistes and Athletes).

Paragraph (2) provides that annuities paid to an individual resident of a Contracting State will be taxable only in that Contracting State. The term "annuities" is defined in paragraph (5) as a stated sum paid periodically at stated times during life, or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration (other than for services rendered).

Paragraph (3) provides that child support payments made by an individual resident of one Contracting State to an individual resident of the other Contracting State will be exempt from tax in that other Contracting State. The term "child support payments" is defined in paragraph (6) as periodic payments for the support of a minor child made pursuant to a written separation agreement or a decree of divorce, separate maintenance, or compulsory support.

This Article is subject to the saving clause of paragraph (3) of Article 6 (General Rules of Taxation). Therefore, individuals who are citizens or residents of a Contracting State may be taxed by that Contracting State without regard to this Article.

Article 19. SOCIAL SECURITY PAYMENTS

This Article provides that social security payments and other public pensions, e.g., railroad retirement benefits, paid by one Contracting State to an individual who is a resident of the other Contracting State (or, in the case of such payments by the Philippines, to an individual who is a citizen of the United States) will be taxable only in the first-mentioned Contracting State. Payments described in Article 20 (Governmental Functions) are not covered by this Article.

Article 20. GOVERNMENTAL FUNCTIONS

Under this Article, wages, salaries, and similar remuneration, including pensions, annuities, or similar benefits, paid from public funds of one Contracting State to a citizen of that Contracting State, or to a citizen of a State other than a Contracting State who comes to the other Contracting State expressly for the purpose of being employed by the first-mentioned Contracting State, for labor or personal services performed as an employee of the national government of that Contracting State, or any agency thereof, in the discharge of functions of a governmental nature will be exempt from tax by the other Contracting State. If the individual becomes a citizen of, or acquires immigrant status in, the other Contracting State, that other Contracting State may tax the individual without regard to this Article. See paragraphs (3) and (4)(b) of Article 6 (General Rules of Taxation). Remuneration or pensions paid in respect of services rendered in connection with any trade or business carried on by one of the Contracting States or any agency thereof will be treated the same as compensation received from a private employer, and the provisions of Articles 15 (Independent Personal Services), 16 (Dependent Personal Services) and 18 (Private Pensions and Annuities), as the case may be, will apply.

This Article applies only to remuneration paid out of public funds by the national government of a Contracting State or its agencies.

Article 21. TEACHERS

Paragraph (1) provides that, if a resident of one Contracting State is invited by the other Contracting State, a political subdivision or local authority thereof, or by a university or other recognized educational institution in that other Contracting State to come to the other Contracting State for a period not expected to exceed 2 years for the purpose of teaching or engaging in research, or both, at a university or other recognized educational institution, and if such resident comes to that other Contracting State primarily for such purpose, his income from personal services for teaching or research at such university or educational institution will be exempt from tax by that other Contracting State for a period not exceeding 2 years from the date of his arrival in that other Contracting State.

Since a temporary visit may be of such a duration that an individual may lose his status as a resident of the Contracting State of which he was a resident at the time he became eligible for the benefits of this Article, the individual need only be a resident of such Contracting State at the beginning of his visit. However, if the individual becomes a citizen of, or acquires immigrant status in, the other Contracting State, that other Contracting State may tax the individual without regard to this Article. See paragraphs (3) and (4)(b) of Article 6 (General Rules of Taxation). If the individual's visit exceeds a period of 2 years from the date of his arrival, the exemption applies only to the income received by the individual before the expiration of such 2-year period. However, if the period of the visit had been expected to exceed two years then the exemption does not apply to any of the income earned. However, if an individual who otherwise meets the requirements of this Article expects to visit for a period of two years for the purpose of teaching and for a subsequent period of, for example, two years for purposes described in paragraph (1) of Article 22 (Students and Trainees), then pursuant to paragraph (4) of Article 22 the exemption provided by this Article does apply.

A person who visits a Contracting State for the purposes explained in this Article and meets the qualifications contained in it may again claim its benefits if he first reestablishes his residence in the other Contracting State. In such a case, the person claiming these benefits on a subsequent occasion must first satisfy the competent authority of the first-mentioned Contracting State that he had become a bona fide resident of the other Contracting State for a substantial period of time.

Pursuant to paragraph (2), this Article does not apply to income from research undertaken not in the general interest (i.e., public interest) but primarily for the private benefit of a specific person or persons other than the person performing the research. For example, research projects which are undertaken to discover or perfect product processes, designs, etc., which are expected to be commercially exploited by the researcher or his present (or former) employer do not qualify under this Article.

Article 22. STUDENTS AND TRAINEES

Paragraph (1) provides that an individual who is a resident of one Contracting State at the time he becomes temporarily present in the other Contracting State and who is temporarily present therein for the primary purpose of studying at a university or other recognized educational institution, securing training required to qualify him to practice a profession or professional specialty, or studying or doing research as a recipient of a grant, allowance, or award from a governmental, religious, charitable, scientific, literary, or educational organization, will be exempt from tax by that other Contracting State, with respect to certain amounts, for a period not exceeding 5 taxable years from the date of his arrival in that other Contracting State. The amounts exempted under this provision are gifts from abroad for the purpose of his maintenance, education, study, research or training; the grant, allowance, or award; and, income from personal services performed in the other Contracting State not in excess of $3,000 (or its equivalent in Philippine pesos) for any taxable year. For United States tax purposes, gifts will be considered to be from abroad when they are borne by a person who is not a resident (as defined in Article 3 (Fiscal Domicile)) of the United States.

Under paragraph (2), an individual who is a resident of one Contracting State at the time he becomes temporarily present in the other Contracting State and who is temporarily present therein as an employee of, or under contract with, a resident of the first-mentioned Contracting State, for the primary purpose of acquiring technical, professional, or business experience from a person other than that resident of the first-mentioned Contracting State or other than a person related to such resident, or studying at a university or other recognized educational institution in that other Contracting State, will be exempt from tax by that other Contracting State for a period not exceeding 12 consecutive months, on income from personal services not in excess of $7,500 or its equivalent in Philippine pesos for any taxable year.

Under paragraph (3), an individual who is a resident of one Contracting State at the time he becomes temporariliy present in the other Contracting State and who is temporarily present therein for a period not exceeding 1 year, as a participant in a program sponsored by the government of the other Contracting State, for the primary purpose of training, research, or study, will be exempt from tax by the other Contracting State with respect to his income from personal services in respect of such training, research, or study performed in that other Contracting State in an aggregate amount not in excess of $10,000 or its equivalent in Philippine pesos for any taxable year.

The monetary limits provided in paragraphs (1), (2), or (3) are in addition to, and not in lieu of, other exemptions provided by the Code. Thus, an unmarried resident of the Philippines who is temporarily present in the United States for the primary purpose of studying at a university

would be entitled to exclude $3,000 of income from the performance of personal services (if he is present in the United States for periods totaling less than 90 days during the taxable year) and, in addition, would be entitled to the personal exemption allowed by section 151 of the Code, as provided in section 873(b) of the Code.

In comparison to paragraph (2)(c) of Article 15 (Independent Personal Services), which provides that the competent authorities may agree in an exchange of letters to a monetary limitation in excess of $10,000 or its equivalent in Philippine pesos, the monetary limitations of paragraphs (1), (2), and (3) cannot be increased by means of an exchange of letters between the competent authorities.

The first sentence of paragraph (4) provides that the benefits provided in paragraph (1) for certain students, trainees and researchers and the benefits provided under Article 21 (Teachers), when taken together, may extend only for such period of time, not to exceed 5 taxable years from the date of the individual's arrival, as may reasonably or customarily be required to effectuate the purpose of the visit. The second sentence of paragraph (4) makes it clear that the benefits provided by Article 21 (Teachers) will not be available to an individual if, during the immediately preceding period, the individual enjoyed the benefits provided by paragraph (1). Thus, a Philippine individual who originally entered the United States for the purpose of becoming a student and received benefits under paragraph (1) must leave the United States and reestablish residence in the Philippines before he can obtain the benefits of Article 21. In such a case, the person claiming the benefits of Article 21 on a subsequent occasion must first satisfy the competent authority of the United States that he had become a bona fide resident of the Philippines for a substantial period of time. In addition, the individual must, of course, meet the requirements of paragraph (1) of Article 21, viz., he must return at the invitation of the United States, a political subdivision or local authority thereof, or a university or other recognized educational institution for the primary purpose of becoming a teacher, etc.

If an individual qualifies for the benefits of more than one of the provisions of this Article, such individual may choose the most favorable provision but may not claim the benefits of more than one provision in any taxable year as a means of avoiding the limitation provided. Thus, for example, an individual who comes to the other Contracting State for the primary purpose of studying may be able to qualify under either paragraph (2) or (3) of this Article. However, he cannot combine the maximum exclusion limits in those two paragraphs to exclude $17,500 during the taxable year. If the individual becomes a citizen of, or acquires immigrant status in, the other Contracting State, that other Contracting State may tax the individual without regard to this Article. See paragraphs (3) and (4)(b) of Article 6 (General Rules of Taxation).

Article 23. RELIEF FROM DOUBLE TAXATION

In order to avoid double taxation, each Contracting State agrees in this Article to provide to its citizens or residents a credit against its taxes for taxes paid by such persons to the other Contracting State.

The United States agrees to allow a United States citizen or resident as a credit against United States tax the appropriate amount of taxes paid or accrued to the Philippines in accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle of paragraph (1)). In addition, in the case of a United States corporation owning at least 10 percent of the voting stock of a Philippine corporation from which it receives dividends in any taxable year, the United States will allow credit for the appropriate amount of taxes paid or accrued to the Philippines by the Philippine corporation paying such dividends with respect to the profits out of which such dividends are paid. The appropriate amount will be based upon the amount of tax paid or accrued to the Philippines but the credit is not to exceed the limitations (for the purpose of limiting the credit to the United States tax on income from sources within the Philippines or on income from sources outside of the United States) provided by United States law for the taxable year. This provision does not require the United States to provide a per-country or overall limitation in the future so long as the general principle of a foreign tax credit remains in effect. For the purpose of applying the United States credit in relation to taxes paid or accrued to the Philippines, the rules set forth in Article 4 (Source of Income) will be applied to determine the source of income, and the taxes referred to in paragraphs (1)(b) and (2) of Article 1 (Taxes Covered) will be considered to be income taxes.

Paragraph (2) provides the general rule that the Philippines will allow a Philippine citizen or resident as a credit against Philippine tax the appropriate amount of income taxes paid or accrued to the United States and, in the case of a Philippine corporation owning at least 50 percent of the voting stock of a United States corporation from which it receives dividends in any taxable year, will also allow credit for the appropriate amount of taxes paid or accrued to the United States by the United States corporation paying such dividends with respect to the profits out of which such dividends are paid. The appropriate amount will be based upon the amount of tax paid or accrued to the United States but will not exceed the limitations (for the purpose of limiting the credit to the Philippine tax on income from sources within the United States and on income from sources outside the Philippines) provided by Philippine law for the taxable year. Under section 30(c)(4) of the Philippine Code, the Philippine foreign tax credit is subject to both the per-country and overall limitations. Of course, the Philippines are not obligated to retain such limitations as long as the principle of a foreign tax credit is retained. For the purpose of applying the Philippine credit in relation to taxes paid or accrued to the United States, the rules set forth in Article 4 (Source of Income) will be applied to determine the source of income and the taxes referred to in paragraphs (1)(a) and (2) of Article 1 (Taxes Covered) will be considered to be income taxes.

The general rule of paragraph (2), that citizens of the Philippines will be given a credit against Philippine tax for income taxes paid or accrued to the United States, is subject to an exception contained in an Exchange of Notes between the Governments of the Philippines and the United States dated November 24, 1976. In that Exchange of Notes, it was agreed that so long as the Philippine Government taxes the worldwide income of Philippine citizens residing outside the Philippines at reduced rates of 1, 2, or 3 percent, the Philippine Government may give a deduction rather than a credit to those citizens for U.S. taxes paid. It was also agreed that in the event that those rates are increased, Article 23 would require the Philippine Government to grant their nonresident citizens a foreign tax credit for U.S. taxes.

Article 24. NONDISCRIMINATION

This Article sets forth the general rules prohibiting discriminatory taxation of residents and corporations of one Contracting State by the other Contracting State. It also reserves to the Philippines the right to limit to its citizens or corporations certain tax incentives in carefully limited circumstances described in currently existing Philippine law.

Paragraph (1) provides that a citizen of one Contracting State who is a resident of the other Contracting State will not be subject in that other Contracting State to more burdensome taxes than a citizen of that other Contracting State who is a resident thereof. The determination of whether more burdensome taxation exists is to be made by comparing the treatment of individuals who are in comparable positions. Thus, for example, a citizen of the Philippines who is a resident of the United States and who otherwise meets the requirements specified in section 911 of the Code would, under this Article, be eligible for the benefits of section 911 even though not a citizen of the United States. On the other hand, just as a United States citizen who becomes a nonresident alien at any time during a taxable year or whose spouse is a nonresident alien at any time during a taxable year cannot file a joint return for that year, a Philippine citizen would not be entitled to file a joint return with his spouse if either is a nonresident alien at any time during the taxable year and the election provided in section 6013(g) of the Code has not been made.

Paragraph (2) provides that a permanent establishment which a resident of one Contracting State has in the other Contracting State will not be subject in that other Contracting State to more burdensome taxes than a resident of that other Contracting State carrying on the same activities. However, this does not obligate a Contracting State to grant to individual residents of the other Contracting State any personal allowances, reliefs, or deductions for taxation purposes on account of civil status or family responsibility which it grants its own individual residents.

Paragraph (3) prohibits one Contracting State from subjecting a corporation of such Contracting State the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State to any taxation or any requirement connected with taxation which is other or more burdensome than those applicable to corporations of the first-mentioned Contracting State carrying on the same activities, the capital of which is wholly or partly owned or controlled by one or more residents of the first-mentioned Contracting State.

Under paragraph (4), the term "taxes" or "taxation" means, for purposes of this Article, taxes or taxation of every kind imposed at the national, state or local level, notwithstanding any other provision of the Convention. However, for other purposes of the Convention, the term "tax" means tax imposed by the United States or the Philippines to which the Convention applies. See paragraph (1)(g) of Article 2 (General Definitions).

Paragraphs (5) and (6) are exceptions to the general rules set forth in paragraphs (1), (2), and (3). Paragraph (5) provides that, with respect to the income tax imposed under Title II of the Philippine Code, nothing in paragraphs (1), (2), and (3) will prevent the Philippines from limiting to its citizens or corporations the enjoyment of tax incentives granted under the following three provisions of Philippine law: section 6 of the Investment Incentives Act (Republic Act No. 5186); sections 5 and 7(b) of the Export Incentives Act (Republic Act No. 6135); and section 9 of the Investment Incentives Program for the Tourism Industry (Presidential Decree No. 535). However, only the incentives which were in force on and have not been modified since Ocrober 1, 1976, the date of signature of the Convention, or have been modified only in minor respects so as not to affect their general character, may be limited to Philippine citizens or corporations.

The policy of the Investment Incentives Act, as expressed in section 2 thereof, is the acceleration of the sound development of the Philippine economy in consonance with the principles and objectives of economic nationalism.

The Investment Incentives Act, the Export Incentives Act, and the Investment Incentives Program for the Tourism Industry represent a broad Philippine program to develop specific areas of the Philippine economy without relinquishing Philippine control thereover. Under that program, certain Philippine corporations can register with the Philippine Board of Investments, and become registered enterprises. To register, generally, 60 percent of a Philippine corporation's voting stock must be owned and controlled by Philippine nationals. If a registered enterprise is engaged in specified preferred economic areas of investment or becomes a pioneer enterprise, the corporation and its investors, both

foreign and Philippine, are entitled to specified economic or tax incentives which are not otherwise granted by Philippine internal law. A pioneer enterprise is a registered enterprise that is engaged in the manufacture, processing, or production of goods, products, or raw materials that are not being produced in the Philippines on a commercial scale or is a registered enterprise which uses a design, formula, scheme, method, process, or system of production or transformation which is new or untried in the Philippines and which involves the substantial use and processing of Philippine raw materials.

The incentives granted under the provisions referred to in paragraph (5) are limited, with one exception which relates to certain Philippine corporations, to Philippine nationals. A Philippine national is a Philippine citizen, a partnership or association wholly owned by Philippine citizens, a Philippine corporation of which at least 60 percent of the outstanding voting shares are owned and held by Philippine citizens, or trustees of certain pension trusts benefitting Philippine nationals.

The following three incentives are granted by section 6 of the Investment Incentives Act to Philippine nationals who invest in pioneer enterprises. First, Philippine nationals are allowed a deduction from their taxable income (which cannot exceed 10 percent of taxable income) for an investment of cash or property made in the form of an acquisition of shares in the original or increased capital stock of a pioneer enterprise. A deduction is allowed only if the investment is made within 7 years from the date of the corporation's registration and the shares are held for a period of not less than 3 years. In addition, Philippine nationals are granted an exemption from Philippine income tax for capital gains which are invested in new issues of capital stock of, or in the purchase of stock owned by foreigners in, pioneer enterprises. However, the investment must be made within 6 months from the date of realization of the gain and the stock must not be disposed of for 3 years. Finally, gain realized by Philippine nationals upon the disposition of stock dividends received from pioneer enterprises are exempt from tax, provided such disposition occurs within 7 years from the date of registration of the enterprise. Section 5 of the Export Incentives Act grants the same three incentives to Philippine nationals for investment in registered export producers that are pioneer enterprises. Section 9 of the Investment Incentives Program for the Tourism Industry grants only two of those incentives--the deduction for investment and the capital gains exemption--to Philippine nationals who invest in registered tourism enterprises.

Section 7(b) of the Export Incentives Act differs from the above described tax incentives in that it applies to the export producer rather than the investor therein. Under that section, a registered export producer which is a Philippine citizen or a Philippine corporation of which 60 percent of its capital is owned and controlled by Philippine citizens is entitled to a deduction from taxable income in an amount equivalent to the sum of the direct labor cost and local raw materials used in the manufacture of export products. That deduction may only be claimed during the 5-year period beginning on the date of its registration and cannot exceed 25 percent of the registered export producer's taxable income.

Other tax incentives found in the above described acts or the presidential decree or in other acts or decrees which result in more burdensome taxation for United States persons resident in the Philippines, or Philippine corporations partly or wholly owned or controlled directly or indirectly by United States residents are subject to the general rules of paragraphs (1), (2), and (3). Thus, United States citizens will be eligible for these incentives.

Paragraph (6) provides that, with respect to taxes other than the income tax imposed under Title II of the Philippine Code, nothing in the first three paragraphs will prevent the Philippines or a political subdivision or local authority thereof from limiting to Philippine citizens or corporations the enjoyment of tax incentives for the promotion of industry or business, similar to those discussed above in connection with paragraph (5). However, only the incentives which were in force on, and have not been modified since October 1, 1976, the date of signature of the Convention, or have been modified only in minor respects so as not to affect their general character, may be limited to Phillipine citizens or corporations.

A final exception to the general rules of paragraphs (1), (2), and (3) relates to the taxation of income derived from the operation of ships and aircraft in international traffic. See the discussion of Article 9 (Shipping and Air Transport), supra.

Article 25. MUTUAL AGREEMENT PROCEDURE

Under paragraph (1), when a resident or citizen of one Contracting State considers that action of one or both Contracting States results or will result for him in taxation not in accordance with the Convention, he may, notwithstanding the remedies provided by the national laws of the Contracting States, present his case to the competent authority of the Contracting State of which he is a resident or citizen. A resident or citizen of a Contracting State need not, although it is anticipated that in the normal situation he will, exhaust his other administrative or judicial remedies prior to resorting to the use of the mutual agreement procedure. If the claim is considered to have merit by the competent authority, that competent authority will endeavor to come to an agreement with the competent authority of the other Contracting State with a view to the avoidance of taxation not in accordance with the Convention.

Paragraph (2) requires the competent authorities of the two Contracting States to endeavor to resolve by mutual agreement any difficulties or doubts arising as to the application of the Convention. In particular, the competent authorities may agree to the same attribution of business profits to a resident of one Contracting State and its permanent establishment situated in the other Contracting State; the same allocation of income, deductions, credits, or allowances between a resident of one Contracting State and a related person and to the readjustment of taxes imposed by each Contracting State to reflect such allocation; the same determination of the source of particular items of income; and, the same characterization of particular items of income.

Under paragraph (3), in implementing the provisions of this Article, the competent authorities may communicate with each other directly and, when advisable, meet together for an oral exchange of opinions.

Under paragraph (4), in cases in which the competent authorities reach an agreement, taxes will be imposed on such income and refund or credit of taxes will be allowed by the Contracting States in accordance with such agreement. In the case of the United States, where an agreement is reached between the competent authorities which requires the United States to make a refund of tax or to extend any other similar credit, such refund or credit will be allowed, notwithstanding procedural barriers otherwise existing under United States law, such as the statute of limitations. In cases where an agreement cannot be reached between the two competent authorities, the United States will not be required to provide any relief for double taxation on a unilateral basis. Paragraph (4), of course, does not authorize the imposition of additional taxes after the statute of limitations has run.

In the case of the Philippines, a refund or cre... will also be allowed, but such refund or credit will be subject to Philippine procedural rules (including the statute of limitations). This permits the Philippines to disallow a claim for refund or credit on the basis of section 309 of the Philippine Code, if that claim is filed later than 2 years from the payment of the tax. However, the Philippines will issue a tax credit certificate, notwithstanding any Philippine procedural rule, such as section 309 of the Philippine Code, if a claim is filed with the competent authority of the Philippines no later than 2 years from the close of the Philippine taxable year in which the United States tax imposed under paragraph (4) is paid. The amount of the tax credit certificate will be computed in the same manner as if an actual refund had been made. It may be used only as a credit against Philippine tax liability and will not give rise to a refund.

When the Philippine tax credit certificate is used by a taxpayer to offset its Philippine tax liability, there is an adjustment in Philippine taxes for U. S. tax credit purposes: the Philippine taxes paid by that taxpayer for the year (or years) with respect to which the certificate was issued are reduced to the extent that the credit authorized in the certificate is used to offset its Philippine taxes in another year (or years). Consequently, for U. S. tax credit purposes, there is no reduction in the taxpayer's Philippine taxes for the year (or years) with respect to which the certificate is used as a credit against its Philippine taxes.

Because books of accounts and other accounting records must be preserved, under section 337 of the Philippine Code, for a period of at least 5 years from the date of the last entry in each book, it is anticipated that the competent authority of the Philippines will have at his disposal

sufficient information to come to an agreement with the competent authority of the United States so that taxation not in accordance with the provisions of the Convention will be avoided. Thus, if a claim for a tax credit certificate is filed within 5 taxable years from the close of the Philippine taxable years in issue, the competent authorities of both Contracting States will communicate or meet and, if agreement is reached, the tax credit certificate will be issued. However, if a claim is filed after the aforementioned 5-taxable year period, the competent authority of the Philippines may not have sufficient information at his disposal to come to an agreement with the competent authority of the United States if the Philippine taxpayer did not preserve its books of accounts or other accounting records for longer than the 5-year minimum period. To facilitate the agreement process between the competent authorities of the two Contracting States, paragraph (4) provides that a tax credit certificate will be issued with respect to a claim filed after the 5-taxable year period beginning with the close of the Philippine taxable year in issue only if the claim is supported by the books and records of the taxpayer.

Article 26. EXCHANGE OF INFORMATION

Paragraph (1) provides for a system of administrative cooperation between the competent authorities of the two Contracting States by requiring an exchange of information necessary for the carrying out of the Convention and of the domestic laws of the Contracting States concerning taxes covered by the Convention insofar as the taxation thereunder is in accordance with the Convention. The competent authorities may exchange information in connection with tax compliance generally, not merely illegal acts or crimes. Information need be exchanged, however, only if it is of a class that can be obtained under the laws and administrative practices of each Contracting State with respect to its own taxes.

Paragraph (2) provides that information exchanged must be treated as secret. However, such information may be disclosed to any persons or authorities concerned with or made part of the public record with respect to the assessment, collection, or enforcement of, or litigation with respect to, the taxes which are the subject of the Convention. Thus, disclosure is not prohibited as a part of a public proceeding before a court or an administrative body.

Paragraph (3) provides that no information may be exchanged which would be contrary to public policy.

Paragraph (4) provides that if information is requested by a Contracting State in accordance with Article 26, the other Contracting State will obtain the information to which the request relates from or with respect to its residents or with respect to its residents or corporations in the same manner and to the same extent as if the tax of the requesting State were the tax of the other State and were being imposed by the other State.

A Contracting State may obtain information from or with respect to its residents or corporations in accordance with paragraph (4) for the sole purpose of assisting the other Contracting State in the determination of the taxes of that other State. Thus, a Contracting State may use the mechanisms provided by its internal law to obtain information for the other Contracting State even if it has no internal tax interest in obtaining that information; its only interest being the request made under paragraph (4).

Paragraph (5) provides that depositions of witnesses and copies of unedited original documents (including books, papers, statements, records, accounts, or writings) may be provided by the competent authority of a Contracting State if specifically requested by the competent authority of the other Contracting State to the extent such depositions and documents can be obtained under the laws and administrative practices of each Contracting State with respect to its own taxes.

Paragraph (6) provides that the exchange of information may be on either a routine basis or on request with reference to particular cases, and that the competent authorities may agree on the list of information to be furnished on a routine basis.

Article 27. ASSISTANCE IN COLLECTION

Paragraph (1) provides that one Contracting State will give the other Contracting State limited assistance in collecting its taxes. Thus, each Contracting State is required to collect on behalf of the other Contracting State only those taxes imposed by such other Contracting State as will ensure that any exemption or reduced rate of tax granted under this Convention by such other Contracting State is not enjoyed by persons not entitled to such benefits.

Paragraph (2) makes clear that a Contracting State is not obligated to carry out measures at variance with the laws or the administrative practice of either Contracting State with respect to the collection of its own taxes.

Article 28. DIPLOMATIC AND CONSULAR OFFICERS

This Article provides that nothing in the Convention will affect the fiscal privileges of diplomatic and consular officials under the general rules of international law or under the provisions of special agreements. This is merely a special case of the general rule provided in paragraph (2) of Article 6 (General Rules of Taxation).

Article 29. ENTRY INTO FORCE

Paragraph (1) provides that the Convention is subject to ratification and provides for the exchange of instruments of ratification. The Convention will enter into force 30 days after the date of exchange of such instruments of ratification. The Convention shall first have effect as respects the rate of withholding of tax, to amounts paid on or after January 1 of the year following the date on which the Convention enters into force and, as respects other taxes, to taxable years beginning on or after January 1 of the year following the date on which the Convention enters into force. However, paragraph (2) provides an exception to those effective dates. Under paragraph (2)(b)(iii) of Article 13 (Royalties), the tax imposed by the Philippines on royalties derived by residents of the United States is limited to an amount that does not exceed the lowest rate of Philippine tax that may be imposed on royalties of the same kind paid under similar circumstances to a resident of a third State. That provision will not have effect before January 1, 1979, with respect to payments received as consideration for the use of, or the right to use, a copyright of cinematographic films or films or tapes used for radio or television broadcasting.

Article 30. TERMINATION

Article 30 provides that the Convention will continue in force indefinitely, but that it may be terminated by either Contracting State at any time after 5 years from the date it enters into force. A Contracting State seeking to terminate the Convention must give at least 6 months' prior notice through diplomatic channels. If the Convention is terminated, such termination will be effective with respect to income of calendar years or taxable years beginning (or, in the cases of taxes payable at source, payments made) on or after January 1 next following the expiration of the 6-month period. It is intended that the reference to calendar years applies only to cases where the taxable year is the calendar year.