TREASURY DEPARTMENT TECHNICAL EXPLANATION OF THE CONVENTION AND PROTOCOL BETWEEN THE UNITED STATES OF AMERICA AND THE SLOVAK REPUBLIC FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME AND CAPITAL SIGNED AT BRATISLAVA ON OCTOBER 8, 1993

This is a technical explanation of the Convention between the United States and the Slovak Republic signed on October 8, 1993 ("the Convention"). The Convention is based on the U.S. Treasury Department's draft Model Income Tax Convention, published on June 16, 1981 ("the U.S. Model"), the Model Tax Convention on Income and Capital published by the OECD in 1992 ("the OECD Model"), and other more recent U.S. income tax conventions. Although the U.S. Model has been withdrawn, and a new Model is being developed as this Technical Explanation is being prepared, the U.S. Model was the relevant Model at the time the Convention was negotiated.

The Technical Explanation is an official guide to the Convention. It reflects the policies behind particular Convention provisions, as well as understandings reached with respect to the application and interpretation of the Convention.

Article 1. GENERAL SCOPE

Paragraph 1 provides that the Convention is applicable to residents of the United States or Slovakia, except where the terms of the Convention provide otherwise. Under Article 4 (Resident), a person is treated as a resident of a Contracting State if that person is, under the laws of that State, liable to tax therein by reason of his domicile or other similar criteria, subject to certain limitations. If a person is, under those criteria, a resident of both Contracting States, a single state of residence (or no state of residence) is assigned under Article 4. These rules govern for all purposes of the Convention. Certain provisions of the Convention are also applicable, however, to persons who may not be residents of either Contracting State. Examples include Articles 20 (Government Service), 25 (Non-Discrimination) and 27 (Exchange of Information and Administrative Assistance).

Paragraph 2 is the same as the corresponding provision in the U.S. Model. Under this paragraph, the Convention may not restrict any exclusion, exemption, deduction, credit or other benefit accorded by the tax laws of the Contracting States or by any other agreement between the Contracting States. In effect, paragraph 2 provides that the Convention may not increase the tax burden on a resident of a Contracting State beyond the burden determined under

domestic law. Thus, a right to tax granted by the Convention to a Contracting State cannot be exercised unless the domestic law of that State also provides for such a tax.

Under the principle of paragraph 2, a taxpayer's liability to U.S. tax need not be determined under the Convention if the Code would produce a more favorable result. This does not mean, however, that a taxpayer may pick and choose among Code and Convention provisions in an inconsistent manner in order to minimize tax. For example, suppose a Slovak resident has three separate businesses in the United States. One is a profitable permanent establishment and the other two are trades or businesses that earn taxable income under the Code but do not meet the permanent establishment threshold tests of the Convention. One trade or business is profitable, and the other incurs a loss. Under the Convention, the income of the permanent establishment is taxable, and both the profit and loss of the other two businesses are ignored. Under the Code, all three would be taxable and the loss would be offset against the profits of the two profitable ventures. In this situation, the taxpayer may not invoke the Convention to exclude the profits of the profitable trade or business and invoke the Code to claim the loss of the loss trade or business against the profit of the permanent establishment. (See Rev. Rul. 84-17, 1984-1 C.B.10.) If the taxpayer invokes the Code for the taxation of all three ventures, however, he would not be precluded from invoking the Convention with respect, for example, to any dividend income he may receive from the United States that is not effectively connected with any of his business activities in the United States.

Paragraph 3 contains the traditional "saving" clause found in all U.S. treaties. Under this paragraph, each of the Contracting States may tax its own residents, citizens and former citizens, in accordance with its domestic law, notwithstanding any Convention provision to the contrary. If, for example, a Slovak resident performs independent personal services in the United States and the income from the services is not attributable to a fixed base in the United States, Article 14 (Independent Personal Services) would normally prevent the United States from taxing the income. If, however, the Slovak resident is also a citizen of the United States, the "saving" clause permits the United States to include the remuneration in the worldwide income of the citizen and subject it to tax under normal Code rules (i.e., without regard to Code section 894(a)). Special foreign tax credit rules applicable to U.S. taxation of certain U.S. income of U.S. citizens resident in Slovakia are provided in paragraph 3 of Article 24 (Relief from Double Taxation).

"Residence," for purposes of the "saving" clause of paragraph 3, is determined under Article 4 (Resident). Thus, for example, if an individual who is not a U.S. citizen is a resident of the United States under the Code, e.g., a "green card" holder, and is also a

resident of Slovakia under Slovak law, and the tie-breaker rules of Article 4 determine that he is a resident of Slovakia, then he will be entitled to U.S. benefits under the Convention.

Paragraph 3 also reserves the right of each Contracting State to tax certain former citizens. In the case of the United States, citizens whose loss of citizenship had as one of its principal purposes the avoidance of U.S. tax may be taxed for a period of ten years following the loss of citizenship in accordance with Code section 877.

Paragraph 4 lists several exceptions to the "saving" clause under which a Contracting State's benefits are extended to its citizens and residents. Under subparagraph a), U.S. residents and citizens are entitled to certain U.S. benefits provided under the Convention: specifically, the correlative adjustments authorized by paragraph 2 of Article 9 (Associated Enterprises); the exemption of social security benefits paid by Slovakia that is provided in paragraph 1(b) of Article 19 (Pensions, Annuities, Alimony, and Child Support); the exemption of nondeductible alimony and child support payments paid by a Slovak resident that is provided in paragraph 4 of Article 19 (Pensions, Annuities, Alimony, and Child Support); the guarantee of a foreign tax credit provided in Article 24 (Relief from Double Taxation); the nondiscrimination protection of Article 25 (Non-Discrimination) and the competent authority procedures of Article 26 (Mutual Agreement Procedure).

Under subparagraph b), certain additional benefits are available to U.S. residents who are neither U.S. citizens nor "green card" holders (such as persons who are residents under the substantial presence test of Code section 7701(b)). These are the benefits extended to employees of the Slovak Government under Article 20 (Government Service); to visiting students, trainees teachers and researchers under Article 21 (Students, Trainees, Teachers and Researchers); and to members of diplomatic and consular missions under Article 28 (Diplomatic Agents and Consular Officers).

Article 2. TAXES COVERED

This Article identifies the U.S. and Slovak taxes to which all Articles of the Convention apply. Two articles of the Convention are also applicable, however, with respect to certain taxes other than those specified in Article 2. Article 25 (Non-discrimination) applies with respect to all taxes imposed at all levels of government, including state and local governments. Article 27 (Exchange of Information and Administrative Assistance) applies with respect to all taxes imposed by a Contracting State (i.e., imposed at the national level).

In the case of the United States, the Convention generally applies to the Federal income taxes imposed by the Internal Revenue Code. Except in the cases of Articles 25 (Non-discrimination) and 27 (Exchange of Information and Administrative Assistance), however, the accumulated earnings tax and personal holding company tax (which are considered penalty taxes) are excluded from coverage, as are the social security taxes provided in Code sections 1401, 3101 and 3111. The Convention applies to the excise taxes imposed with respect to the investment income of private foundations under Code sections 4940 et seq., but does not apply (except in the case of Articles 25 and 27) with respect to the excise taxes imposed on insurance premiums paid on policies issued by foreign insurers under Code section 4371.

In the case of Slovakia, the Convention generally applies to the income taxes imposed by the Slovak income tax law and to the Slovak tax on immovable property (the real property tax). As noted above, Article 25 (Non-Discrimination) applies to all taxes imposed at all levels of government in Slovakia and Article 27 (Exchange of Information and Administrative Assistance) applies to all national level taxes imposed by Slovakia.

Under paragraph 2, the Convention will apply to any taxes that are identical or substantially similar to those enumerated in paragraph 1 and that are imposed in addition to, or in place of, the existing taxes after October 8, 1993 (the date of signature of the Convention). Paragraph 2 also provides that the U.S. and Slovak competent authorities will notify each other of significant changes in their taxation laws. This refers to changes that are of significance to the operation of the Convention. The competent authorities will also notify each other of official published materials concerning the application of the Convention. This refers to such materials as technical explanations, regulations, rulings and judicial decisions relating to the Convention.

Article 3. GENERAL DEFINITIONS

Paragraph 1 defines a number of basic terms used in the Convention. Certain other terms are defined in other articles of the Convention. For example, the term "resident of a Contracting State" is defined in Article 4 (Resident). The term "permanent establishment" is defined in Article 5 (Permanent Establishment). The terms "dividends," "interest" and "royalties" are defined in Articles 10 (Dividends), 11 (Interest) and 12 (Royalties), respectively. The introductory language makes clear that the definitions specified in paragraph 1 apply for purposes of the Convention, and apply unless the context otherwise requires. The latter condition allows flexibility in interpretation of the treaty in order to avoid results not intended by the treaty's negotiators.

Subparagraph 1(a) defines the term "Contracting State" to mean the United States or Slovakia, depending on the context in which the term is used.

Subparagraph 1(b) defines the term "United States" to mean the United States of America. The term does not include Puerto Rico, the Virgin Islands, Guam or any other U.S. possession or territory. When used in a geographical sense, the "United States" includes the territorial sea and the seabed and subsoil of the adjacent area over which the United States may exercise rights in accordance with international law and in which U.S. tax law is in force. Currently, under Code section 638, U.S. tax law applies on the continental shelf only with respect to the exploration for and exploitation of mineral resources.

Subparagraph 1(c) defines the term "Slovakia" to mean the Slovak Republic.

Subparagraph 1(d) defines the term "person" to include an individual, an estate, a trust, a partnership, a company and any other body of persons. This definition conforms to the definition in the U.S. Model. Any such person may be a "resident" of a Contracting State for purposes of Article 4 (Resident) and thus entitled to the benefits of the Convention.

Subparagraph 1(e) defines the term "company" as any body corporate or any entity treated as a body corporate for tax purposes. For U.S. tax purposes, the rules of Treas. Reg. §301.7701-2 generally will apply to determine whether an entity is a body corporate. Similarly, for U.S. tax purposes, a publicly traded partnership, as defined in Code section 7704, will be treated as a company for purposes of the Convention.

Subparagraph 1(f) defines the terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" to mean an enterprise carried on by a resident of the appropriate Contracting State. Thus an enterprise of a Contracting State need not be carried on in that State. It may be carried on in the other State or in a third state.

Subparagraph 1(g) defines the term "international traffic" to mean any transport by a ship or aircraft, except when such transport is solely between places within a Contracting State. The exclusion from international traffic of transport solely between places within a Contracting State means, for example, that the transport of goods or passengers solely between New York and Chicago by a Slovak carrier (if permitted) would not be treated as international traffic, and the resulting income would not be exempt from U.S. tax under Article 8 (Shipping and Air Transport). The income would, however, be treated as business profits under Article 7 (Business Profits) and would therefore be taxable in the United States only if attributable to a U.S. permanent establishment and only on a net basis. If, however, goods or passengers are carried

by a Slovak airline from Bratislava to New York and then to Chicago, the entire trip would be international traffic. This would be true even if a Slovak carrier transferred goods at the U.S. port of entry from a ship or plane to a land vehicle, or if the overland portion of the trip in the United States were handled by an independent carrier under contract with the Slovak carrier, so long as both parts of the trip were reflected in the original bill of lading.

Subparagraph 1(h) defines the term "competent authority." The competent authorities are charged with administering the provisions of the Convention and with attempting to resolve any doubts or difficulties that may arise in interpreting its provisions. The U.S. competent authority is the Secretary of the Treasury or his delegate. The Secretary of the Treasury has delegated the competent authority function to the Commissioner of Internal Revenue, who has, in turn, delegated the authority to the Assistant Commissioner (International). With respect to interpretive issues, the Assistant Commissioner acts with the concurrence of the Associate Chief Counsel (International) of the Internal Revenue Service. In Slovakia, the competent authority is the Minister of Finance or his authorized representative.

Paragraph 2 provides that, in the application of the Convention, any term used but not defined in the Convention will have the meaning that it has under the tax law of the Contracting State whose tax is being applied. If, however, the meaning of a term cannot be readily determined under the law of a Contracting State, or if there is a conflict in meaning under the laws of the two States that creates difficulties in the application of the Convention, the competent authorities may, pursuant to paragraph 3 of Article 26 (Mutual Agreement Procedure), agree to a common meaning in order to prevent double taxation or further any other purpose of the Convention. Likewise, if the definition of a term under either paragraph 1 of Article 3 or the tax law of a Contracting State would result in a circumstance unintended by the treaty negotiators or by the Contracting States (e.g., due to a change in the statutory definition of the term since the signing date of the Convention), the competent authorities may agree to a common meaning of the term. This common meaning need not conform to the meaning of the term under the laws of either Contracting State.

Article 4. RESIDENT

This Article sets forth rules for determining whether a person is a resident of a Contracting State for purposes of the Convention. As a general matter, only residents of the Contracting States may claim the benefits of the Convention. The Convention definition of residence is to be used only for purposes of the Convention. The fact that a person is determined to be a resident

of a Contracting State under Article 4 does not necessarily entitle a person to the benefits of the Convention. In addition to being a resident, a person must qualify for benefits under Article 17 (Limitation on Benefits).

Under paragraph 1, the determination of residence for Convention purposes looks first to a person's liability to tax as a resident under the respective taxation laws of the Contracting States. Thus a person who is liable to tax under the laws of a Contracting State by reason of his domicile, residence, place of management, place of incorporation or any other similar criterion is treated as a resident of that State. A person who, under those laws, is a resident of one Contracting State and not of the other generally need look no further.

Paragraph 2 provides several exceptions to the general rule of paragraph 1. Under subparagraph 2(a), a person who is liable to tax in a Contracting State only in respect of income from sources within that State, or capital situated therein, will not be treated as a resident of that Contracting State for purposes of the Convention. Thus, for example, a Slovak consular official who is posted in the United States, and who is subject to U.S. tax on U.S. source investment income but not on non-U.S. source income, would not be considered a resident of the United States for purposes of the Convention. (In most cases such an individual also would not be a U.S. resident under the Code.)

Under subparagraph 2(b), a partnership, estate or trust will be treated as a resident of a Contracting State to the extent that the income derived by the partnership, estate, or trust is subject to tax in that State as the income of a resident, whether in the hands of the partnership, estate or trust deriving the income or in the hands of its partners, beneficiaries or grantors. This rule is applied to determine the extent to which a partnership, estate or trust is entitled to Convencion benefits with respect to income that it receives from the other Contracting State. Under U.S. law, a partnership (other than certain publicly traded limited partnerships and partnerships that are reclassified as associations under Treas. Reg. § 301.7701-2) is never, and an estate or trust often is not, a taxable entity. Thus, for Convention purposes, income received by a U.S. partnership need only be treated as received by a U.S. resident to the extent that it is included in the distributive share of partners who are U.S. residents (looking through any partnerships that are themselves partners). Similarly, the treatment under the Convention of income received by a U.S. trust or estate will be determined by the residence for taxation purposes of the person subject to tax on such income, which may be the grantor, the beneficiaries or the estate or trust itself, depending on the particular circumstances. A joint venture that is taxed in Slovakia as a resident enterprise will be a resident of Slovakia for Convention purposes, even if it is characterized as a partnership under U.S. law.

Under subparagraph 2(c), a U.S. citizen or a nonresident alien lawfully admitted for permanent residence (a "green card" holder) will be treated as a U.S. resident by Slovakia for purposes of the Convention only if such individual has a substantial presence, permanent home or habitual abode in the United States. Therefore, a U.S. citizen or "green card holder whose permanent home or habitual abode is not in the U.S. and not in Slovakia and who does not stay in the U.S. long enough to be a U.S. resident under code § 7701 will not be entitled to benefits under this treaty.

Under subparagraph 3(a), the two Contracting States, their political subdivisions and local authorities, and agencies and instrumentalities thereof, are to be treated as residents of those States for purposes of Convention benefits. Under subparagraph 3(b), a pension trust or any other organization that is constituted and operated exclusively to provide pension benefits or for religious, charitable, scientific, artistic, cultural or educational purposes and that, in any such case, is a resident of a Contracting State under the laws of that State is to be treated as a resident of that State for purposes of the Convention. This rule applies notwithstanding the fact that all or part of the organization's income may be exempt from income tax under the internal laws of that State.

Paragraph 4 provides a series of tie-breaker rules to determine a single State of residence for an individual who, under the laws of the two Contracting States, and thus under paragraph 1, is deemed to be a resident of both Contracting States. These rules come from the OECD Model. The first rule establishes residence where the individual has a permanent home. If that test is inconclusive because the individual has a permanent home available to him in both States, he will be considered to be a resident of the Contracting State with which his personal and economic relations are closest, i.e., the location of his "center of vital interests." If that test is also inconclusive, or if he does not have a permanent home available to him in either State, he will be treated as a resident of the Contracting State where he maintains an habitual abode. If he has an habitual abode in both States or in neither of them, he will be treated as a resident of his Contracting State of citizenship. If he is a citizen of both States or of neither, the competent authorities are instructed to determine his residence by mutual agreement.

Paragraph 5 seeks to settle dual-residence issues for companies (defined in Article 3 (General Definitions) as entities treated as a body corporate for tax purposes). A company is treated as resident in the United States if it is created or organized under the laws of the United States or a political subdivision thereof. A company is treated as a resident of Slovakia if its place of registration is in Slovakia. In most cases it is expected that the place of incorporation and registration will be the same. However, in the event that a

company is a resident of both countries under their respective domestic laws, this paragraph provides that the company will be deemed to be a resident only of the State under whose laws it was created.

Paragraph 6 provides that where a person, other than an individual or a company, is a resident of both Contracting States under their respective laws, the competent authorities will establish a single country of residence by mutual agreement and determine how the Convention is to apply to such person.

Article 5. PERMANENT ESTABLISHMENT

This Article defines the term "permanent establishment," which is relevant to several articles of the Convention. The existence of a permanent establishment in a Contracting State is necessary under Article 7 (Business Profits) for that State to tax the business profits of a resident of the other Contracting State. Articles 10 (Dividends), 11 (Interest) and 12 (Royalties) provide for reduced rates of tax at source on payments of these items of income to a resident of the other State only when the income is not attributable to a permanent establishment or fixed base that the recipient has in the source State. If the income is attributable to a permanent establishment, Article 7 (Business Profits) applies, and if the income is attributable to a fixed base, Article 14 (Independent Personal Services) applies.

Paragraph 1 provides the basic definition of the term "permanent establishment." As used in the Convention, the term means a fixed place of business through which the business of an enterprise is wholly or partly carried on. In the case of an individual, Article 14 (Independent Personal Services) uses the concept of a "fixed base," rather than a "permanent establishment," but the two concepts are considered to be parallel.

Paragraph 2 contains a list of examples of fixed places of business that constitute a permanent establishment: a place of management, a branch, an office, a factory, a workshop, and a mine, oil or gas well, quarry or other place of extraction of natural resources. The use of singular nouns in this illustrative list is not meant to imply that each such place of business constitutes a separate permanent establishment. In the case of mines or wells, for example, several such places of business could constitute a single permanent establishment if the project is a whole commercially and geographically.

Subparagraph 3(a) adds that a building site or construction or installation project, or an installation or drilling rig or ship used to explore for or exploit natural resources, also constitutes a permanent establishment, but only if it lasts more than 12 months. This 12-month threshold is the same as that provided in

the U.S. and OECD models and applies separately to each individual site or project. The testing period begins when work (including preparatory work carried on by the resident) physically begins in a Contracting State. A series of contracts or projects that are interdependent both commercially and geographically are to be treated as a single project. For example, the construction of a housing development would be considered a single project even if each house is constructed for a different purchaser. Likewise, the drilling of several wells within the same geographic area or by the same resident will be considered a single permanent establishment. If the 12-month threshold is exceeded, the site or project constitutes a permanent establishment from its first day. This interpretation of the Article is based on the Commentaries to paragraph 3 of Article 5 of the OECD Model, which constitute the generally accepted international interpretation of the language in paragraph 3 of Article 5 of the Convention.

Subparagraph 3(b) provides that the furnishing of services, including consultancy services, by an enterprise through employees or other personnel will constitute a permanent establishment, but only if activities of that nature continue (whether for the same or a connected project) within the country for a period or periods aggregating more than nine months within any 12-month period. A permanent establishment is not considered to exist, however, under either subparagraph 3(a) or 3(b) in any taxable year in which the activity described in such subparagraph continues for a period or periods aggregating less than 30 days in that taxable year.

Paragraph 4 lists a number of activities that may be carried on through a fixed place of business but that, nevertheless, will not give rise to a permanent establishment. Under subparagraph 4(a), the use of facilities solely to store, display or deliver merchandise belonging to an enterprise will not constitute a permanent establishment of that enterprise. Under subparagraphs 4(b) and (c), the maintenance of a stock of goods belonging to an enterprise solely for the purpose of storage, display or delivery, or solely for the purpose of processing by another enterprise will not give rise to a permanent establishment of the first-mentioned enterprise. Under subparagraphs 4(d) and (e), the maintenance of a fixed place of business solely for purchasing goods or collecting information for the enterprise, or for carrying out any other activity of a preparatory or auxiliary character for the enterprise (e.g., advertising, the supply of information or certain research activities), will not constitute a permanent establishment of the enterprise. Finally, under subparagraph 4(f), a combination of the activities described in paragraph 4 will not give rise to a permanent establishment.

Paragraphs 5 and 6 specify when the use of an agent will constitute a permanent establishment. Under paragraph 5, a dependent agent of an enterprise is deemed to be a permanent establishment of the enterprise if the agent has and habitually

exercises an authority to conclude contracts in the name of that enterprise. If, however, his activities are limited to those activities specified in paragraph 4 that would not constitute a permanent establishment if carried on by the enterprise through a fixed place of business, the agent is not a permanent establishment of the enterprise.

Under paragraph 6, an enterprise is not deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through an independent agent, including a broker or general commission agent, if the agent is acting in the ordinary course of his business as an independent agent.

Paragraph 7 clarifies that a company that is a resident of a Contracting State will not be deemed to have a permanent establishment in the other Contracting State merely because it controls, or is controlled by, a company that is a resident of that other Contracting State, or that carries on business in that other Contracting State. The determination of whether a permanent establishment exists will be made solely on the basis of the factors described in paragraphs 1 through 6 of the Article. Whether a company is a permanent establishment of a related company, therefore, is based solely on those factors and not on the ownership or control relationship between the companies.

Article 6. INCOME FROM REAL PROPERTY (IMMOVABLE PROPERTY)

Paragraph 1 provides the general rule that income derived by a resident of a Contracting State from real property located in the other Contracting State (including income from agriculture or forestry) may be taxed in that other State. The income may also be taxed in the State of residence. Thus the Article does not grant an exclusive taxing right to the situs State, but merely grants it the primary right to tax. The Article does not impose any limitation in terms of rate or form of tax on the situs State, except that, as provided in paragraph 5, the situs State must allow the taxpayer an election to be taxed on a net basis.

Paragraph 2 defines the term "real property" by reference to the internal law of the situs State. In addition, the paragraph specifies certain classes of property that, regardless of internal law definitions, are to be included within the meaning of the term for purposes of the Convention. The term "real property" in no event includes ships, boats or aircraft.

Paragraph 3 clarifies that all forms of income from the exploitation of real property are taxable in the situs State, including but not limited to income from direct use of real property by the owner and rental income from the letting of real property. Income from the disposition of real property, however,

is not considered to be "derived" from real property and is not covered by this Article. The taxation of such income is addressed in Article 13 (Gains). Similarly, interest paid on a mortgage on real property and distributions by a U.S. Real Estate Investment Trust are not considered to be "derived" from real property. The taxation of these items is addressed in Articles 10 (Interest) and 11 (Dividends), respectively.

Paragraph 4 clarifies that income from real property of an enterprise is covered by this Article, and not by Article 7 (Business Profits). Similarly, income from real property used for the performance of independent personal services is covered by this Article, and not by Article 14 (Independent Personal Services). Thus the situs State may tax the real property income of a resident of the other State in the absence of attribution to a permanent establishment or fixed base.

Paragraph 5 provides that a resident of one Contracting State that derives real property income from the other Contracting State may be taxed in that other State on a net basis, as if the income were attributable to a permanent establishment in that other State. For purposes of taxation by the United States, an election to be taxed on a net basis will be binding for the taxable year of the election and for all subsequent taxable years, unless the U.S. competent authority agrees to terminate the election. The election is based on the U.S. Model provision, which reflects U.S. law (Code section 871(d)).

Article 7. BUSINESS PROFITS

This Article provides the rules for the taxation by a Contracting State of the business profits of an enterprise of the other Contracting State. Paragraph 1 provides the general rule that business profits (as defined in paragraph 7) of an enterprise of one Contracting State may not be taxed by the other Contracting State unless the enterprise carries on or has carried on business in that other Contracting State through a permanent establishment (as defined in Article 5 (Permanent Establishment)) situated there. Where that condition is met, the State in which the permanent establishment is situated may tax the business profits of the enterprise, but only so much as is attributable to the assets or activity of that permanent establishment.

Paragraph 2 provides that the Contracting States will attribute to a permanent establishment the profits that it might be expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions. The computation of business profits attributable to a permanent establishment under this paragraph is subject to the rules of paragraph 3 for the allowance of expenses incurred for purposes of earning the income.

Profits attributable to a permanent establishment are taxable in the State where the permanent establishment is situated or was situated at the time the profits were derived. This rule incorporates the rule of Code section 864(c)(6) with respect to deferred payments, which is also reflected in the provisions of Articles 11 (Interest), 12 (Royalties), 14 (Independent Personal Services) and 22 (Other Income) dealing with amounts attributable to a permanent establishment or fixed base. If income was attributable to a permanent establishment or fixed base when earned, it is taxable by the State where the permanent establishment or fixed base was located, even if receipt of the income is deferred until the permanent establishment or fixed base has ceased to exist.

The concept of "attributable to" in paragraph 2 is analogous to, but narrower than, the concept of "effectively connected" in Code section 864(c). For example, the profits attributable to a permanent establishment may be from sources within or without a Contracting State. Thus, Code section 864(c)(B) is consistent with paragraph 2, i.e., certain items of foreign source income described in Code section 864(c)(4)(B) may be attributed to a U.S. permanent establishment of a Slovak resident and subject to tax in the United States. The "asset use" and "business activities" tests of Code section 864(c)(2) are also consistent with the "attributable to" concept. As discussed in connection with paragraph 5, however, the limited "force of attraction" rule in Code section 864(c)(3) is not applicable under the Convention.

Paragraph 3 provides that, in determining the business profits of a permanent establishment, deductions shall be allowed for expenses that are incurred for the purposes of the permanent establishment. These include expenses directly incurred by the permanent establishment and a reasonable allocation of expenses incurred by the home office, or by other permanent establishments of the home office, as long as the expenses were incurred on behalf of the company as a whole or a part of it that includes the permanent establishment. Allocable expenses include executive and general administrative expenses, research and development expenses, interest and other similar expenses, wherever incurred and without regard to whether they are actually reimbursed by the permanent establishment.

Paragraph 4 provides that no business profits will be attributed to a permanent establishment merely because it purchases goods or merchandise for the enterprise of which it is a permanent establishment. This rule refers to a permanent establishment that performs more than one function for the enterprise, including purchasing. For example, the permanent establishment may purchase raw materials for the enterprise's manufacturing operation and sell the manufactured output. While business profits may be attributable to the permanent establishment with respect to its sales activities, no profits are

attributable to it with respect to its purchasing activities. If the sole activity of the office were the purchasing of goods or merchandise for the enterprise, however, the issue of the attribution of income would not arise. Under subparagraph 4(d) of Article 5 (Permanent Establishment), the office would not be a permanent establishment to which profits could be attributed.

Under paragraph 5, the business profits attributed to a permanent establishment are only those profits derived from its assets or activities. This paragraph clarifies that the "limited force of attraction" concept of Code section 864(c)(3) is not incorporated into the Convention. The paragraph is also intended to assure consistent tax treatment over time for permanent establishments by providing that profits shall be determined by the same method of accounting each year, unless there is good reason to change the method used. This provision restricts both the Contracting State in changing accounting methods to be applied to permanent establishments and permanent establishments seeking to change accounting methods. This provision, however, does not restrict a Contracting State from imposing additional requirements on a permanent establishment, as provided in its law, in the event of a change in accounting method, to prevent amounts from being duplicated or omitted (see Code section 481).

Paragraph 6 provides that nothing in this Article shall affect the application of any law of a Contracting State relating to the determination of the tax liability of any person in cases where the information available to the competent authority of that State is inadequate to determine the profits to be attributed to a permanent establishment. In any such case, however, the determination of the profits of the permanent establishment must be consistent with the principles stated in this Article (to the extent possible based on the available information).

Paragraph 7 defines the term "business profits" to mean generally any income derived from any trade or business. Business profits include, specifically, income from the furnishing of the personal services of other persons, but do not include compensation received by an individual for the performance of personal service, whether as an employee or in an independent capacity. Thus a consulting firm resident in one State whose employees perform services in the other State through a permanent establishment may be taxed in that other State on a net basis under Article 7. The salaries of the employees, however, will be subject to the rules of Article 15 (Dependent Personal Services).

Paragraph 8 coordinates the provisions of this Article and other provisions of the Convention. Under paragraph 8, where business profits include items of income that are dealt with separately under other articles of the Convention, the provisions of those articles will, except where they specifically provide to the contrary, take precedence over the provisions of Article 7.

Thus, for example, the taxation of interest will be determined by the rules of Article 11 (Interest), and not by Article 7, except where (as provided in paragraph 4 of Article 11) the interest is attributable to a permanent establishment.

This Article is subject to the "saving" clause of paragraph 3 of Article 1 (General Scope) of the Model. Thus, if a citizen of the United States who is a resident of Slovakia under the Convention derives business profits from the United States that are not attributable to a permanent establishment in the United States, the United States may, subject to the special foreign tax credit rules of paragraph 3 of Article 24 (Relief from Double Taxation), tax those profits, notwithstanding the provisions of this Article.

Article 8. SHIPPING AND AIR TRANSPORT

This Article governs the taxation of profits from the operation of ships and aircraft in international traffic. Under paragraph 1, profits derived by an enterprise of a Contracting State from the operation of ships or aircraft in international traffic are taxable only in that State. By virtue of paragraph 8 of Article 7 (Business Profits), profits of an enterprise of a Contracting State that are exempt in the other Contracting State under this paragraph are exempt in that other State even if the enterprise has a permanent establishment there.

Paragraph 2 defines the term "profits from the operation of ships or aircraft in international traffic" to include profits derived from the rental of ships or planes on a full (time or voyage) basis (i.e., with crew) for use in international traffic. The term also includes profits derived from the leasing of ships or aircraft on a bareboat basis (i.e., without crew) for use in international traffic, provided that the lessor is an enterprise engaged in the operation of ships or aircraft in international traffic and the profits are incidental to such activities.

Paragraph 3 provides that profits derived by an enterprise of a Contracting State from the use, maintenance or rental of containers (including trailers, barges and related equipment for the transport of containers) used in international traffic are exempt from tax in the other Contracting State. This result obtains whether the enterprise is engaged in the operation of ships or aircraft in international traffic or is a leasing company, and whether or not the enterprise has a permanent establishment in that other Contracting State.

Paragraph 4 clarifies that the provisions of paragraph 1 apply to income from participation in a pool, joint business, or international operating agency. This refers to various arrangements for international cooperation by carriers in shipping and air transport. For example, if the Slovak airline were to form

a consortium with other national airlines, the Slovak participant's share of the total income derived by the consortium from U.S. sources would be covered by this Article.

Article 9. ASSOCIATED ENTERPRISES

This Article incorporates into the Convention the general principles of Code section 482. It provides generally that when a resident of one Contracting State engages in transactions with a related person resident in the other Contracting State, and such transactions are not conducted on an arm's length basis, the Contracting States may make appropriate adjustments to the taxable income and tax liability of such persons to reflect the income or tax liability with respect to such transactions that each person would have had if the relationship between them had been at arm's length.

Paragraph 1 deals with the circumstances where an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or when the same persons participate directly or indirectly in the management, control, or capital of an enterprise of one Contracting State and of an enterprise of the other Contracting State. The term "control" includes any kind of control, whether or not legally enforceable and however exercised or exercisable. If, in either circumstance, the two enterprises make or impose conditions in their commercial or financial relations that differ from the conditions that would exist in relations between independent enterprises, the competent authorities may adjust the income of the related enterprises to reflect the profits that would have accrued to either enterprise if the two enterprises had been independent of each other.

Paragraph 2 provides that, where a Contracting State has made an adjustment that is consistent with the provisions of paragraph 1, the other Contracting State will make a corresponding adjustment to the tax liability of the related enterprise in that other State. It is understood that the other Contracting State need adjust its tax only if it agrees that the initial adjustment under paragraph 1 is appropriate. The Contracting State making an adjustment under this paragraph will take the other provisions of the Convention into account. For example, if the effect of a correlative adjustment is to treat a Slovak corporation as having made a distribution of profits to its U.S. parent corporation, the provisions of Article 10 (Dividends) will apply to that distribution. The competent authorities are authorized to consult, if necessary, to resolve any differences in the application of this paragraph.

Paragraph 2 of Article 26 (Mutual Agreement Procedure) explains that any correlative adjustment made under this paragraph

will be implemented, notwithstanding any time limits or procedural limitations in the law of the Contracting State making the adjustment. The "saving" clause of paragraph 3 of Article 1 (General Scope) does not apply to paragraph 2 of Article 9. Thus even if the statute of limitations has run, or there is a closing agreement between the Internal Revenue Service and the taxpayer, a refund of tax can be made in order to implement a correlative adjustment. Statutory or procedural limitations, however, cannot be overridden to impose additional tax, because, under paragraph 2 of Article 1 (General Scope), the Convention cannot restrict any statutory benefit.

Under paragraph 3, the provisions of paragraph 2 are not applicable in the case of fraud, gross negligence or willful default.

Article 10. DIVIDENDS

This Article provides rules for the taxation of dividends and similar amounts paid by a company resident in one Contracting State to a resident of the other Contracting State. The article permits full residence State taxation of such dividends and limited source State taxation. Article 10 also provides rules for the imposition of a tax on branch profits by the State of source.

Paragraph 1 preserves the residence State's general right to tax its residents on dividends paid by a company that is a resident of the other Contracting State. The same result is achieved by the "saving" clause of paragraph 3 of Article 1 (General Scope).

Paragraph 2 grants the source State the right to tax dividends paid by a company that is a resident of that State to a resident of the other Contracting State. If the beneficial owner of the dividend is a company that owns at least 10 percent of the voting shares of the company paying the dividend, the tax that may be imposed by the source State is limited to 5 percent of the gross amount of the dividend. In all other cases, the source State tax is limited to 15 percent of the gross amount of the dividend. Indirect ownership of voting shares (e.g., through tiers of corporations) and direct or indirect ownership of nonvoting shares are not considered for purposes of determining eligibility for the 5 percent direct investment dividend rate.

Paragraph 3 relaxes the limitations on source country taxation for dividends paid by a U.S. Regulated Investment Company (RIC) or Real Estate Investment Trust (REIT). A dividend paid by a RIC is subject to the 15 percent portfolio dividend rate, regardless of the percentage of voting shares of the RIC held directly by the recipient of the dividend. Generally, the reduction of the direct investment dividend rate to 5 percent is intended to relieve multiple levels of corporate taxation in cases where the recipient

of the dividend holds a substantial interest in the payor. This rationale does not justify a reduction of the rate in the case of dividends paid by RICs, because RICs do not pay corporate tax with respect to amounts distributed to their shareholders. Further, although amounts received by a RIC may have been subject to U.S. corporate tax (e.g., dividends paid by a publicly traded U.S. company to a RIC), it is unlikely that a 10 percent shareholding in a RIC by a Slovak resident will correspond to a 10 percent shareholding in the entity that has paid U.S. corporate tax (e.g., the publicly traded U.S. company). Thus, in the case of dividends received by a RIC and paid out to its shareholders, the requirement of a substantial shareholding in the entity paying the corporate tax is generally lacking.

In the case of a dividend paid by a U.S. REIT to a Slovak resident, the U.S. statutory rate i.e., 30 percent, generally applies (except in the case of amounts subject to tax as effectively connected income under Code section 897(h)). Dividends beneficially owned by an individual holding a less than 10 percent interest in the REIT are eligible, however, for the 15 percent portfolio dividend rate provided in paragraph 3. The denial of the 15 percent portfolio rate to corporate shareholders and 10 percent or greater individual shareholders is intended to prevent indirect investment in U.S. real property through a REIT from receiving more favorable treatment than direct investment in such real property.

Paragraph 4 defines the term "dividends," as used in this Article, to include income from any shares, "jouissance" rights, mining shares, founders' shares or other rights that are not debt claims and that participate in profits; income from other corporate rights that is subjected to the same taxation treatment as income from shares by the laws of the Contracting State of which the company making a distribution is a resident; and income from arrangements, including debt obligations, if such arrangements carry the right to participate in profits and the income is characterized as a dividend under the domestic law of the Contracting State in which the income arises.

Paragraph 5 provides that, where dividends are attributable to a permanent establishment or fixed base that the beneficial owner maintains in the country of source, they are not subject to the provisions of paragraph 2 of this Article, but instead are taxable under Article 7 (Business Profits) or Article 14 (Independent Personal Services), as appropriate. Such dividends will be taxed on a net basis using the rates and rules of taxation generally applicable to residents of the Contracting State in which the permanent establishment or fixed base is located, as modified by the Convention.

Paragraph 6 permits a Contracting State to impose a "branch profits tax" on a corporation that is a resident of the other State. Under paragraph 6, a Contracting State may impose a tax, in

addition to other taxes permitted by the Convention, on a corporation that is a resident of the other Contracting State and that maintains a permanent establishment in the first mentioned State or that is subject to net basis taxation in that State under Article 6 (Income from Real Property (Immovable Property)) or Article 13 (Gains). The additional tax may not exceed 5 percent of the income of the corporation that is attributable to a permanent establishment in the taxing State or subject to tax on a net basis in that State, after deducting the taxes on profits imposed thereon in that other State and after adjustment for increases or decreases in the assets, net of liabilities, of the corporation connected with the permanent establishment or the trade or business. Such tax may only be imposed if, under the domestic law of the taxing State, it applies to the permanent establishment of any nonresident corporation. The U.S. tax will be imposed in accordance with Code section 884, subject to the limitation provided for in this Article. For U.S. tax purposes, the limitation is understood to correspond to 5 percent of the "dividend equivalent amount," as defined in Code section 884.

Under paragraph 7, where a company that is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose tax on the dividends paid by the company, except insofar as such dividends are paid to a resident of that other State or insofar as the holding in respect of which the dividends are paid forms part of the business property of a permanent establishment or a fixed base situated in that other State. This result obtains even if the dividends paid consist wholly or partly of profits or income arising in such other State.

Article 11. INTEREST

Paragraph 1 grants to each Contracting State the exclusive right (subject to paragraphs 2 and 4) to tax interest beneficially owned by a resident of that Contracting State and arising in the other Contracting State.

Paragraph 2 reserves the right of the United States to tax an excess inclusion of a residual holder of a Real Estate Mortgage Investment Conduit (REMIC) in accordance with its law. Thus, the tax on such an excess inclusion of a Slovak resident would be subject to the U.S. statutory rate of withholding tax, i.e., 30 percent.

Paragraph 3 defines the term "interest," as used in the Convention, to include income from debt claims of every kind, whether or not secured by a mortgage, and, subject to paragraph 4 of Article 10 (Dividends), whether or not carrying a right to participate in profits. The term "interest" includes, in particular, income from government securities, income from bonds or

debentures, and any premiums or prizes attaching to such securities, bonds or debentures, and all other income treated as interest by the taxation law of the source State. The definition does not refer to penalties and fines for late payment, which are frequently excluded from the treaty definition of interest. However, such amounts would also be exempt from tax at source under Article 22 (Other Income).

Paragraph 4 provides an exception from the rule of paragraph 1 in cases where the beneficial owner of the interest, who is a resident of one Contracting State, carries on business through a permanent establishment in the other Contracting State or performs independent personal services through a fixed based situated in that other State and the interest is attributable to that permanent establishment or fixed base. In such a case, the income is taxable to the permanent establishment or fixed base in accordance with the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services). This rule applies even if the permanent establishment or fixed base no longer exists when the interest is received or accrued, as long as the interest would have been attributable to the permanent establishment or fixed base if it had been received or accrued in the earlier year, i.e., because the debt claim on which the interest is paid was attributable to the permanent establishment in such earlier year.

Paragraph 5 provides a source rule for interest. Under this paragraph, interest is deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the payer (whether or not a resident of a Contracting State) has in a Contracting State a permanent establishment or fixed base, and such interest is borne by such permanent establishment or fixed base, then such interest shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.

Paragraph 6 provides that if, as a result of a special relationship between the payer and the beneficial owner of the interest, or between both of them and some other person, the interest paid is excessive, Article 11 applies only to the amount of interest payments that would have been made absent such special relationship (i.e., an arm's length interest payment). Any excess amount of interest paid remains taxable according to the laws of the United States and Slovakia, respectively, with due regard to the other provisions of the Convention. Thus, for example, if the excess amount would be treated as a distribution of profits, such amount could be taxed as a dividend, rather than as interest, subject to the provisions of Article 10 (Dividends).

Because the rule of paragraph 2 provides for exemption at source of interest derived by a resident of the other Contracting State, the United States will not impose tax under Code section 884 on excess interest of a U.S. branch of a Slovak company.

Article 12. ROYALTIES

Paragraph 1 grants to each Contracting State the right (subject to paragraph 2, discussed below) to tax royalties beneficially owned by its residents and arising in the other Contracting State.

Paragraph 3 defines the term "royalties" as used in the Convention. Under subparagraph 3(a), the term "royalties" includes payments of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic, or scientific work, including cinematographic films or films or tapes and other means of image or sound reproduction. The reference to "other means" of reproduction makes clear that subsequent technological advances will not affect the exclusion of payments relating to the use of such means of image or sound reproduction from the definition of royalties. Under subparagraph 3(b), the term also includes payments for the use of, or right to use, any patent, trademark, design or model, plan, secret formula or process, or other like right or property, or for industrial, commercial, or scientific equipment or for information concerning industrial, commercial, or scientific experience. In addition, the term "royalties" includes gains from the alienation of any right or property described in paragraph 3 that is contingent on the productivity, use, or further disposition of the property.

Under paragraph 2, royalties described in subparagraph 3(a) ("copyright royalties") that are paid by a resident of one Contracting State and beneficially owned by a resident of the other Contracting State are taxable only in that other Contracting State, i.e., the residence State of the beneficial owner. The scope of the term "copyright" as used in the paragraph is determined under domestic law. Royalties described in subparagraph 3(b) ("industrial royalties") may be taxed both by the source State and by the residence State of the beneficial owner, but the tax that may be imposed by the source State is limited to 10 percent of the gross amount of the royalties. Taxation of any royalties arising in one Contracting State and derived and beneficially owned by a resident of the other Contracting State is a departure from the U.S. model. Inclusion of equipment rentals under the definition of royalties is a further departure from the U.S. model. However, like a number of countries, Slovakia feels strongly about this point and the maximum treaty rate of 10% does represent a significant reduction of the Slovak nontreaty rate of 25%.

Paragraph 4 provides an exception to the rules of paragraphs 1 and 2 in cases where a beneficial owner of royalties who is a resident of one Contracting State carries on or has carried on business through a permanent establishment in the other Contracting State or performs independent personal services through a fixed base in that other State and the royalties are attributable to that permanent establishment or fixed base, i.e., the right or property

in respect of which the royalties are paid forms part of the business property of such permanent establishment or fixed base. In such a case, the royalties are taxable in accordance with the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), and the source State will generally retain the right of taxation. This rule applies even if the permanent establishment or fixed base no longer exists when the royalties are paid or accrued, as long as the royalties would have been attributable to the permanent establishment or fixed base if they had been paid or accrued in the earlier year, e.g., because the license in respect of which the royalties are paid was attributable to the permanent establishment in such earlier year.

Paragraph 5 provides that if, as a result of a special relationship between the payer and the beneficial owner of a royalty, or between both of them and some other person, the royalty paid is excessive, Article 12 applies only to the amount of the royalty payment that would have been made absent such special relationship (i.e., an arm's length royalty payment). Any excess amount of royalty paid remains taxable according to the laws of the United States and Slovakia, respectively, with due regard to the other provisions of the Convention. If, for example, the excess amount is treated as a distribution of profits by a company under the internal law of the source State, such excess amount will be taxed as a dividend, rather than as a royalty payment, subject to the provisions of Article 10 (Dividends).

Paragraph 6 provides source rules for royalty payments. Under subparagraph 6(a), royalties are treated as arising in a Contracting State when the payer is that State itself, a political subdivision or local authority of that State or a person who is a resident of that State for purposes of its tax. Where, however, the person paying the royalties (whether or not a resident of one of the Contracting States) has in a Contracting State a permanent establishment or fixed base in connection with which the liability to pay royalties was incurred, and the royalties are borne by the permanent establishment or fixed base, then the royalties are deemed to arise in the State in which the permanent establishment or fixed base is situated. Where subparagraph 6(a) does not apply to treat royalties as arising in a Contracting State, subparagraph 6(b) treats royalties paid for the use of, or the right to use, any property or right described in paragraph 3 in a Contracting State as arising in that State.

Article 13. GAINS

This Article provides rules for source and residence State taxation of gains from the alienation of property.

Paragraph 1 provides that gains derived by a resident of one Contracting State from the alienation of real property situated in

the other Contracting State may be taxed in the other (situs) State. This paragraph is intended to preserve the right of the United States to tax the full range of gains taxable under section 897 of the Code.

For purposes of Article 13, paragraph 2 defines the term "real property situated in the other Contracting State" to include real property referred to in Article 6 (Income from Real Property (Immovable Property)) (i.e., interests in the immovable property itself) and certain indirect interests in real property. Such indirect interests include shares of stock in a company at least 50 percent of the assets of which consist of real property situated in the source State. Thus, a Slovak resident would be subject to U.S. tax on gain from the alienation of shares in a United States Real Property Holding Corporation. Similarly, such a resident would be subject to tax on a liquidating distribution by such a U.S. corporation and on a distribution by a REIT attributable to gain from the alienation of U.S.-situs real property. This provision also preserves the U.S. right to tax gain from the alienation of an interest in a partnership, trust or estate, to the extent that the gain is attributable to U.S.-situs real property.

Paragraph 3 preserves the right of the source State to tax gains from the alienation of personal (movable) property in certain circumstances. Under paragraph 3, gains from the alienation of movable property forming part of the business property of a permanent establishment that an enterprise of a Contracting State has in the other Contracting State, or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base, may be taxed in that other State.

Paragraph 4 provides that gains derived by an enterprise of a Contracting State from the alienation of ships, aircraft or containers used in international traffic are taxable only in that State.

Paragraph 5 clarifies that payments described in paragraph 3 of Article 12 (Royalties), including gains from the alienation of any right or property described in paragraph 3 of Article 12 that is contingent on the productivity, use, or further disposition of the property, are taxable only in accordance with the provisions of Article 12.

Paragraph 6 grants to the residence State the exclusive right to tax gains from the alienation of property other than property referred to in paragraphs 1 through 5.

Article 14. INDEPENDENT PERSONAL SERVICES

The Convention deals in separate articles with different classes of income from personal services. Article 14 deals with the general class of income from independent personal services, and Article 15 deals with the general class of income from employment (dependent personal services). Exceptions and additions to these general rules are provided for directors' fees in Article 16; for performance income of artistes and sportsmen in Article 18; for pensions in respect of personal service income and social security benefits in Article 19; for government service salaries and pensions in Article 20; and for certain income of students, trainees, teachers and researchers in Article 21.

Under paragraph 1, income derived by an individual who is a resident of one Contracting State from the performance of personal services in an independent capacity in the other Contracting State is exempt from tax in that other State unless the services are or were performed in that other State (see Code section 864(c)(6)) and either (a) the income is attributable to a fixed base regularly available to the individual in that other State for the purpose of performing his services, in which case the income attributable to that fixed base may be taxed in that other State, or (b) the individual remained in that other State for more than an aggregate of 183 days in any twelve month period. The State of residence may tax in either case under paragraph 3 of Article 1 (General Scope). In addition, under paragraph 3 of Article 1 (General Scope), if the individual is a Slovak resident who performs independent personal services in the United States, and the individual is also a U.S. citizen, the United States may tax his income without regard to the restrictions of this Article, subject to the special foreign tax credit rules of paragraph 3 of Article 24 (Relief from Double Taxation).

The term "fixed base" is not defined in the Convention, but its meaning is understood to be analogous to that of the term "permanent establishment." Therefore, it is understood that the income attributed to a fixed base will be taxed in accordance with principles similar to those provided in Article 7 (Business Profits) for the taxation of business enterprises. However, in this case, only income from services performed in a Contracting State may be attributed to a fixed base in that State.

Paragraph 2 notes that the term "personal services" includes independent scientific, literary, artistic, educational or teaching activities, as well as the independent activities of physicians, lawyers, engineers, architects, dentists, and accountants. This list, which is derived from the OECD Model, is not exhaustive. The term includes all personal services performed by an individual for his own account, where he receives the income and bears the risk of loss arising from the services. The taxation of income from the

types of independent services that are covered by Articles 16 and 18 through 21 is governed by the provisions of those articles.

Article 15. DEPENDENT PERSONAL SERVICES

This Article deals with the taxation of remuneration derived by a resident of a Contracting State for the performance of personal services in the other Contracting State as an employee.

Under paragraph 1, remuneration derived by an employee who is a resident of a Contracting State may be taxed by his State of residence. This is the same result as achieved by paragraph 3 of Article 1 (General Scope). However, to the extent that the remuneration is derived from an employment exercised (the performance of services) in the other Contracting State, the remuneration also may be taxed by that other Contracting State unless the conditions specified in paragraph 2 are satisfied.

Paragraph 1 also provides that the more specific rules of Articles 16 (Directors' Fees), 19 (Pensions, Annuities, Alimony, and Child Support), 20 (Government Service), and 21 (Students, Trainees, Teachers, and Researchers) apply in the case of employment income described in one of these articles. Thus, even though the State of source has a general right to tax employment income under Article 15, it may not have the right to tax a particular type of income under the Convention if that right is proscribed by one of the aforementioned articles. Similarly, though a State of source may have no general right of taxation under Article 15 with respect to a particular item of income, the State may have the right to tax that income under one of the aforementioned Articles.

Under paragraph 2, remuneration of an individual resident of a Contracting State that is derived from the performance of services as an employee within the other Contracting State may not be taxed by that other Contracting State if three conditions are satisfied: (a) the individual is present in that State for a period or periods not exceeding in the aggregate 183 days in any twelve month period; (b) the remuneration is paid by, or on behalf of, an employer who is not a resident of that other Contracting State; and (c) the remuneration is not borne by a permanent establishment or fixed base that the employer has in that other State. If a foreign employer pays the salary of an employee, but a host country corporation or permanent establishment reimburses the foreign employer in a deductible payment that can be identified as a reimbursement, neither condition (b) nor (c) will be considered to have been fulfilled. Conditions (b) and (c) are intended to ensure that a Contracting State will not be required both to allow a deduction to the payor for the amount paid and to exempt the employee on the amount received. In order for the remuneration to

be exempt from tax in the source State, all three conditions must be satisfied.

Paragraph 3 contains a special rule applicable to remuneration for services performed by an individual who is a resident of a Contracting State as an employee aboard a ship or aircraft operated in international traffic. Such remuneration may be taxed only in the Contracting State of residence of the employee if the services are performed as a member of the regular complement of the ship or aircraft. This rule is similar to the corresponding provision in the U.S. Model. The "regular complement" of a ship or aircraft includes the crew. In the case of a cruise ship, it may also include others, such as entertainers, lecturers, etc., employed by the shipping company to serve on the ship. The use of the term "regular complement" is intended to clarify that a person who exercises his employment as, for example, an insurance salesman while aboard a ship or aircraft is not covered by this paragraph.

If a U.S. citizen who is resident in Slovakia performs dependent services in the United States and meets the conditions of paragraph 2, or is a crew member on a Slovak ship or airline, and would therefore be exempt from U.S. tax if he were not a U.S. citizen, he is nevertheless taxable in the United States on his remuneration by virtue of the saving clause of paragraph 3 of Article 1 (General Scope), subject to the special foreign tax credit rules of paragraph 3 of Article 24 (Relief from Double Taxation).

Article 16. DIRECTORS' FEES

This Article provides that a Contracting State may tax the fees paid by a company that is a resident of that State for services performed by a resident of the other Contracting State in his capacity as a director of the company, provided that the services are performed in the first-mentioned State. This rule is an exception to the more general rules of Article 14 (Independent Personal Services) and Article 15 (Dependent Personal Services). Thus, for example, in determining whether a non-employee director's fee is subject to tax in the State of residence of the company, whether the company constitutes a fixed base of the director in that State is not relevant.

The rule provided in this Article represents a departure from the U.S. Model, which treats a corporate director in the same manner as any other individual performing personal services -- outside directors would be subject to the provisions of Article 14 (Independent Personal Services) and inside directors would be subject to the provisions of Article 15 (Dependent Personal Services). The preferred Slovak position is reflected in the OECD Model, in which a resident of one Contracting State who is a

director of a company that is resident in the other Contracting State is subject to tax in that other State in respect of his directors' fees regardless of where the services are performed. The provision in Article 16 of the Convention represents a compromise between these two positions. The State of residence of the company may tax nonresident directors with no threshold, but only with respect to remuneration for services performed in that State.

This Article is subject to the "saving" clause of paragraph 3 of Article 1 (General Scope). Thus, if a U.S. citizen who is a Slovak resident is a director of a U.S. corporation, the United States may tax his full remuneration regardless of the place of performance of his services.

Article 17. LIMITATION ON BENEFITS

Article 17 ensures that source basis tax benefits granted by a Contracting State pursuant to the Convention are limited to the intended beneficiaries -- residents of the other Contracting State -- and are not extended to residents of third States not having a substantial business in, or business nexus with, the other Contracting State. For example, a resident of a third State might establish an entity resident in a Contracting State for the purpose of deriving income from the other Contracting State and claiming source State benefits with respect to that income. Absent Article 17, the entity would generally be entitled to benefits as a resident of a Contracting State, subject to such limitations, e.g., business purpose, substance-over-form, step transaction or conduit principles, as may be applicable to the transaction or arrangement under the domestic law of the source State.

Article 17 is more detailed than the corresponding article in the U.S. Model and follows the form of the article used in more recent treaties. See, e.g., Convention Between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes. The structure of the Article is as follows: Paragraph 1 lists a series of attributes of a resident of a Contracting State, any one of which will entitle that person to benefits of the Convention in the other Contracting State. Paragraph 2 provides that benefits also may be granted to a person not entitled to benefits under the tests of paragraph 1, if the competent authority of the source State determines that it is appropriate to provide benefits in that case. Paragraph 3 defines the term "recognized securities exchange" as used in subparagraph 1(c). Paragraph 4 defines the term "gross income" as used in subparagraph 1(e)(ii).

The first two categories of persons eligible for benefits from the other Contracting State under the Convention are individual

residents of a Contracting State (subparagraph 1(a)) and the two Contracting States and their political subdivisions or local authorities (subparagraph 1(b)). It is considered unlikely that persons falling into these two categories can be used improperly to derive treaty benefits on behalf of a third-country resident. If an individual is receiving income as a nominee on behalf of a third-country resident, benefits will be denied with respect to those items of income under the articles of the Convention that grant the benefit, because of the requirements in those articles that the beneficial owner (and not merely the recipient) of the income be a resident of a Contracting State.

The third category, described in subparagraph 1(c), consists of persons that are residents of one Contracting State and derive income from the other Contracting State that is connected with, or incidental to, an active trade or business conducted in the residence State. Income that is derived in connection with, or is incidental to, the business of making or managing investments will not qualify for benefits under this provision, unless the business is a bank or insurance company engaged in banking or insurance activities. The first six examples in the Memorandum of Understanding Regarding the Scope of the Limitation on Benefits Article in the Convention Between the Federal Republic of Germany and the United States of America (German Convention) illustrate the situations covered by subparagraph 1(c).

The fourth category, described in subparagraph 1(d), consists of companies in whose principal class of shares there is substantial and regular trading on a recognized securities exchange (as defined in paragraph 3) and companies that are wholly owned, directly or indirectly, by a company that is a resident of the same Contracting State and whose principal class of shares are so traded.

The fifth category, described in subparagraph 1(e), includes not-for-profit organizations (including a pension fund or private foundation) that satisfy two conditions: (a) the organization is generally exempt from tax in its State of residence by virtue of its not-for-profit status and (b) more than half of the beneficiaries, members, or participants, if any, in the organization are persons who are entitled under this Article to benefits of the Convention.

The sixth category, described in subparagraph 1(f) of paragraph 1, includes persons who satisfy two tests: the so-called "ownership" and "base erosion" tests. The "ownership" test requires that more than 50 percent of the beneficial interest in the person (or, in the case of a company, more than 50 percent of each class of its shares) be owned, directly or indirectly, by persons who are themselves entitled to benefits under the other tests of paragraph 1 (other than subparagraph c)). The "base erosion" test requires that not more than 50 percent of the

person's gross income (as defined in paragraph 4) be used, directly or indirectly, to meet liabilities (including liabilities for interest or royalties) to persons not entitled to benefits under the other tests of paragraph 1 (other than subparagraph c)).

The rationale for the two-part test of subparagraph 1(f) derives from the fact that treaty benefits can be indirectly enjoyed not only by equity holders of an entity, but also by that entity's various classes of obligees, such as lenders, licensors, service providers, insurers and reinsurers, and others. In order to prevent such benefits from inuring substantially to third-country residents, it is not sufficient merely to require substantial ownership of the entity by treaty country residents or their equivalent. It is also necessary to require that the entity's deductible payments be made in substantial part to such treaty country residents or their equivalents. For example, a third-country resident could lend funds to a Slovak-owned Slovak corporation to be reloaned to the United States. The U.S. source interest income of the Slovak corporation would be exempt from U.S. withholding tax under Article 11 (Interest) of the Convention. While the Slovak corporation would be subject to Slovak income tax, its taxable income could be reduced to near zero by the deductible interest paid to the third-country resident. If, under a Convention between Slovakia and the third country, that interest is exempt from Slovak tax, the U.S. treaty benefit with respect to the U.S. source interest income will have flowed to the third-country resident.

It is intended that the provisions of paragraph 1 will be self-executing. Unlike the provisions of paragraph 2, discussed below, a claim of benefits under paragraph 1 does not require advance competent authority ruling or approval. The tax authorities may, of course, determine on review that the taxpayer has improperly interpreted the paragraph and is not entitled to the benefits claimed.

Paragraph 2 of Article 17 permits the competent authority of the State in which income arises to grant Convention benefits in additional cases, even if they do not meet the standards of paragraph 1 (or sufficient information is not available to make such a determination). This discretionary provision is included in recognition that, with the increasing scope and diversity of international economic relations, there may be cases where significant participation by third-country residents in an enterprise of a Contracting State is warranted by sound business practice and does not indicate a motive of attempting to derive unintended Convention benefits.

Paragraph 3 defines the term "recognized securities exchange" as used in subparagraph 1(d). In the case of the United States, this term means the NASDAQ System owned by the National Association of Securities Dealers, Inc. and any stock exchange registered with

the Securities and Exchange Commission as a national securities exchange for purposes of the Securities Exchange Act of 1934. In the case of Slovakia, the term means the Slovak stock exchange (Burza Cennych Papierov Bratislava A.S.) and any other stock exchange approved by the Slovak State authorities. The term "recognized securities exchange" also includes any other stock exchange located in a Contracting State and agreed upon by the competent authorities.

Paragraph 4 defines the term "gross income," as used in subparagraph 1(e)(ii), generally to mean gross receipts. In the case of an enterprise engaged in a manufacturing or production business, the term "gross income" means gross receipts reduced by the direct costs of labor and materials attributable to such manufacture or production and paid or payable out of such receipts.

Article 18. ARTISTES AND SPORTSMEN

Article 18 addresses the taxation in a Contracting State of artistes (i.e., performing artists and entertainers) and athletes resident in the other Contracting State from the performance of their services as such. The Article applies both to the income of an entertainer or athlete who performs services on his own behalf and one who performs his services on behalf of another person, either as an employee of that person or pursuant to any other arrangement. The rules of this Article take precedence over those of Article 14 (Independent Personal Services) and 15 (Dependent Personal Services). This Article applies, however, only with respect to the income of performing artists and athletes. Others involved in a performance or athletic event, such as producers, directors, technicians, managers, coaches, etc., remain subject to the provisions of Articles 14 and 15.

Paragraph 1 describes the circumstances in which a Contracting State may tax the performance income of an entertainer or athlete who is a resident of the other Contracting State. Under the paragraph, income derived by a resident of a Contracting State from his personal activities as an entertainer or athlete exercised in the other Contracting State may be taxed in that other State if the amount of the gross receipts derived by the individual exceeds $20,000 (or its equivalent in Slovak crowns) for the taxable year concerned. The $20,000 includes expenses reimbursed to the individual or borne on his behalf. If the gross receipts exceed $20,000, the full amount, not just the excess, may be taxed in the State of performance.

The OECD Model provides for taxation by the country of performance of the remuneration of entertainers with no dollar or time threshold. The United States introduces the dollar threshold test to distinguish between two groups of entertainers and athletes -- those who are paid very large sums of money for very short

periods of service, and who would, therefore, normally be exempt from host country tax under the standard personal services income rules, and those who earn only modest amounts and are, therefore, not clearly distinguishable from those who earn other types of personal service income.

Paragraph 1 applies notwithstanding the provisions of Articles 7 (Business Profits), 14 (Independent Personal Services) or 15 (Dependent Personal Services). Thus, if an individual would otherwise be exempt from tax under those Articles, but is subject to tax under this Article, he may be taxed. An entertainer or athlete who receives less than the $20,000 threshold amount, and who is, therefore, not affected by this Article, may nevertheless be subject to tax in the host country under Article 14 or 15 if the tests for taxability under those Articles are met. For example, if an entertainer who is an independent contractor earns only $19,000 of income for the calendar year, but the income is attributable to a fixed base regularly available to him in the State of performance, that State may tax his income under Article 14. It is frequently not possible to know until year end whether the income and entertainer or athlete derived from performance in a Contracting State will exceed $20,000. Nothing in the Convention precludes that Contracting State, however, from withholding tax during the year and refunding after the close of the year if the taxability threshold has not been met.

Paragraph 2 is intended to deal with the potential for abuse when income from a performance by an entertainer or athlete does not accrue to the performer himself, but to another person. Foreign entertainers commonly perform in the United States as employees of, or under contract with, a company or other person. The relationship may truly be one of employee and employer, with no abuse of the tax system either intended or realized. On the other hand, the "employer" may be, for example, a company established and owned by the performer that is merely acting as the nominal income recipient in respect of the remuneration for the performer's performance. The performer may be acting as an "employee," receiving a modest salary and arranging to receive the remainder of the income from his performance in another form or at a later time. In such a case, absent the provisions of paragraph 2, the company providing the entertainer's services can escape host country tax because it earns business profits but has no permanent establishment in that country. The performer may largely or entirely escape host country tax by receiving only a small salary in the year the services are performed, perhaps small enough to place him below the dollar threshold in paragraph 1. He would arrange to receive further payments in a later year, when he is not subject to host country tax, perhaps as salary payments, dividends, or liquidating distributions.

Paragraph 2 seeks to prevent this type of abuse while at the same time protecting the taxpayers' rights to the benefits of the

Convention when there is a legitimate employee-employer relationship between the performer and the person providing his services. Under paragraph 2, when the income accrues to a person other than the performer, and the performer (or persons related to him) participate, directly or indirectly, in the profits of that other person, the income may be taxed in the Contracting State where the performer's services are exercised, without regard to the provisions of the Convention concerning business profits (Article 7) or independent personal services (Article 14). Thus, even if the "employer" has no permanent establishment or fixed base in the host country, its income may be subject to tax there under the provisions of paragraph 2. Taxation under paragraph 2 is on the person providing the services of the entertainer or athlete. This paragraph does not affect the rules of paragraph 1, which apply to the entertainer or athlete himself. To the extent of salary payments to the performer, which are treated under paragraph 1, the income taxable by virtue of paragraph 2 to the person providing his services is reduced.

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

The paragraph 2 override of the protection of Articles 7 (Business Profits) and 14 (Independent Personal Services) does not apply if it is established that neither the entertainer or athlete, nor any persons related to the entertainer or athlete, participate directly or indirectly in the profits of the person providing the services of the entertainer or athlete. Thus, for example, if a circus owned by a U.S. corporation performs in Bratislava, the Slovak promoters of the performance pay the circus, which in turn pays salaries to the clowns. The circus has no permanent establishment in Slovakia. Since the clowns do not participate in the profits of the circus, but merely receive their salaries out of the circus' gross receipts, the circus is protected by Article 7 and its income is not subject to Slovak tax. Whether the salaries of the clowns are subject to Slovak tax depends on whether they exceed the $20,000 threshold in paragraph 1. This exception for non-abusive cases to the paragraph 2 override of the Articles 7 and 14 protection of persons providing the services of entertainers and athletes is not found in the OECD Model. The policy reflected in this exception is, however, consistent with the stated intent of Article 17 of that Model, as indicated in its Commentaries. The Commentaries to Article 17 state that paragraph 2 is intended to counteract certain tax avoidance devices in which income is diverted from the performer to another person in order to minimize

the total tax on the remuneration. It is therefore consistent not to apply these rules in non-abusive cases.

Paragraph 3 is not found in the U.S. or OECD Models. It provides an exception to the rules in paragraphs 1 and 2 in the case of a visit to a Contracting State by an entertainer or athlete who is a resident of the other Contracting State, if the visit is substantially supported, directly or indirectly, by the public funds of his State of residence or of a political subdivision or local authority of that State. In the circumstances described, only the Contracting State of residence of the entertainer or athlete may tax his income from the performances so supported in the other State.

This Article is subject to the provisions of the saving clause of paragraph 3 of Article 1 (General Scope). Thus, if an entertainer or athlete who is a resident in Slovakia is a citizen of the United States, the United States may tax all of his income from performances in the United States without regard to the provisions of this Article, subject, however, to the special foreign tax credit provisions of paragraph 3 of Article 24 (Relief from Double Taxation).

Article 19. PENSIONS, ANNUITIES, ALIMONY, AND CHILD SUPPORT

This Article deals with the taxation of private and public pensions and annuities, alimony and child support payments.

Paragraph 1 provides in subparagraph a) that pensions and other similar remuneration derived and beneficially owned by a resident of a Contracting State in consideration of past employment may be taxed only by the State of residence of the beneficial owner. The past employment need not have been exercised by the beneficial owner of the pension. For example, a pension paid to a surviving spouse who is a resident of Slovakia would be exempt from tax by the United States on the same basis as if the right to the pension had been earned directly by the surviving spouse. A pension may be paid in installments or in a lump sum.

Subparagraph 1(b) provides that social security benefits and other public pensions paid by a Contracting State to a resident of the other Contracting State or a citizen of the United States may be taxed only by the paying State. This rule applies to benefits paid under the social security legislation of both Contracting States and certain U.S. Railroad Retirement benefits.

The rule of subparagraph 1(b) is an exception to the "saving" clause of paragraph 3 of Article 1 (General Scope). Thus, a Slovak social security benefit will be exempt from U.S. tax even if the beneficiary is a U.S. resident or a U.S. citizen (whether resident in the United States, Slovakia, or a third country). The rules of

paragraph 1 do not apply to pensions for governmental service, which are dealt with in Article 20 (Government Service).

Under paragraph 2, annuities that are derived and beneficially owned by a resident of a Contracting State are taxable only in that State. An annuity, as the term is used in this paragraph, means a stated sum paid periodically at stated times during a specified number of years, under an obligation to make the payment in return for adequate and full consideration (other than for services rendered).

Paragraphs 3 and 4 deal with alimony and child support payments. The provisions of the two paragraphs differ, in some respects, from the comparable provisions in the U.S. Model so that they may better coordinate the provisions of U.S. and Slovak law regarding the treatment of such payments. Paragraph 3 deals only with those alimony payments that are deductible to the payor. Under the paragraph, alimony paid by a resident of a Contracting State, to the extent that it is deductible by that resident, to a resident of the other Contracting State is taxable only in the State of residence of the recipient. Paragraph 4 deals with nondeductible alimony and periodic payments for the support of a minor child. These types of payments by a resident of a Contracting State to a resident of the other Contracting State are taxable only in the State of residence of the payor.

Both alimony, under paragraph 3, and nondeductible alimony and child support payments, under paragraph 4, are defined as periodic payments made pursuant to a written separation agreement or decree of divorce, separate maintenance, or compulsory support. In addition, for a payment to be treated as "alimony" for purposes of this Article, it must be taxable to the recipient under the laws of his State of residence.

Under U.S. law, alimony is generally deductible to the payer and taxable in the hands of the recipient. Such payments made by U.S. residents, therefore, fall within the terms of paragraph 3 and are taxable only in Slovakia. Under Slovak law, to the extent alimony is deducted by the payer, it is taxable to the recipient. In such cases, alimony paid by Slovak residents also falls under paragraph 3.

The "saving" clause of paragraph 3 of Article 1 does not apply to paragraph 4. The benefits of this paragraph, therefore, are not overridden by any contrary provisions of the Code.

Article 20. GOVERNMENT SERVICE

This Article follows the corresponding provisions of the OECD Model. The Article provides generally that payments (including a pension) from the public funds of a Contracting State or political

subdivision or local authority thereof to compensate a citizen of that State for the performance of services rendered in the discharge of functions of a governmental nature may be taxed only by that State. Payments in respect of services rendered in connection with a business carried on by that State, political subdivision or local authority (for example, a government-operated airline) are governed by the provisions of Article 14 (Independent Personal Services), 15 (Dependent Personal Services) or 18 (Artistes and Sportsmen), as the case may be, and not by Article 20.

The provisions of this Article do not apply to social security benefits and other public pensions that are not paid in respect of services rendered to the paying government or a political subdivision or local authority thereof. Such amounts are governed by the provisions of Article 19 (Pensions, Annuities, Alimony and Child Support).

The rules of this Article are an exception to the "saving" clause of paragraph 3 of Article 1 (General Scope) for individuals who are neither citizens nor permanent residents of the State where the services are performed. Thus, for example, payments by Slovakia to its employees at the Slovak Embassy in Washington are exempt from U.S. tax if the employees are not "green card" holders or citizens of both countries.

Article 21. STUDENTS, TRAINEES, TEACHERS AND RESEARCHERS

This Article deals with visiting students, trainees, and, unlike the U.S. Model, teachers and researchers.

Paragraph 1 deals with certain payments received by a student who is temporarily present in the host State for the primary purpose of study at an accredited educational institution, securing professional training, or study or research as the recipient of a grant from a governmental, religious, charitable, scientific, literary or educational organization. If such a student was a resident of the other Contracting State at the beginning of his visit, he will be exempt from tax in the host State on (i) payments (other than compensation for personal services) arising from sources, or remitted from, outside the host State, that are for the purpose of the student's or trainee's maintenance, education or training, (ii) the study or research grant, and (iii) income from personal services performed in the host State in an aggregate amount not exceeding $5,000 or its equivalent in Slovak crowns for any taxable year. These exemptions are available for a period of time not exceeding five years from the date of the student's arrival in the host State. It is expected that, in most cases, study, training or research programs would be completed within five years.

The reference in paragraph 1 to "primary purpose" is meant to describe individuals participating in a full-time program of study, training, or research. It was substituted for the reference in the OECD Model to "exclusive purpose" to prevent too narrow an interpretation. It is not the intention to exclude full-time students who, in accordance with their visas, may hold part-time employment jobs. For U.S. purposes, a religious, charitable etc. organization as described in subparagraph 1(c) is an organization that qualifies as tax-exempt under Code section 501(c)(3).

Paragraph 2 deals with a resident of a Contracting State who is an employee of an enterprise of that State and who is temporarily present in the other Contracting State for the primary purpose of studying at an accredited educational institution in the host State or acquiring technical, professional or business experience from a person other than his employer. Such resident will be exempt from tax by the host State for a period of 12 consecutive months on compensation for personal services, wherever performed, in an aggregate amount not exceeding $8,000 or its equivalent in Slovak crowns.

Paragraph 3 of the Article deals with a resident of a Contracting State who is temporarily present in the other Contracting State for a period not exceeding one year, as a participant in a program sponsored by the Government of the host State, for the primary purpose of training, research or study. Such an individual will be exempt from tax by the host State on compensation for personal services in respect of such training, research or study performed in the host State in an aggregate amount not exceeding $10,000 or its equivalent in Slovak crowns.

Paragraph 4 permits the competent authorities to agree to adjust the dollar amounts specified in paragraphs 1 through 3 to reflect significant changes in price levels over time. The exemption for income from personal services in paragraphs 1 through 3 applies only if the services are performed solely for the purposes of supplementing the funds otherwise available for the person's maintenance, education or training. The $5,000 exemption applies in addition to, and not in lieu of, any allowances (e.g., personal exemptions and deductions) available to the person under the internal laws of the Contracting States. If the amount earned exceeds $5,000 per annum, only the excess is taxable.

Paragraph 5 of the Article deals with visiting professors and teachers. Although there is no provision in the U.S. or OECD Models dealing with professors or teachers, and it is not standard U.S. treaty policy to provide benefits to visiting teachers by treaty, the United States will frequently agree to include such a provision when requested by the treaty partner. Paragraph 5 provides that if a professor or teacher who is a resident of one Contracting State visits the other Contracting State for a period not exceeding two years for the purpose of teaching or conducting

research at an accredited educational or research institution, he will be exempt from tax in the host State on his compensation for such teaching or research. A person is not entitled to the benefits of this paragraph if he has, during the immediately preceding period, enjoyed the benefits of paragraph 1, 2 or 3 of Article 21 as a student, apprentice or trainee. If, however, following the period in which a person claimed benefits under paragraph 1, 2 or 3, that person resumes residence and physical presence in his original home State before returning to the host State as a teacher or researcher, he may claim the benefits of paragraph 5. The benefits of paragraph 5 may be claimed only once by a particular individual.

Paragraph 6 clarifies that, for the exemption of paragraph 5 to apply to income from research, the research must be undertaken in the public interest, and not primarily for the private benefit of a specific person or persons. For example, the exemption would not apply to a grant from a tax-exempt research organization to search for the cure to a disease if the results of the research become the property of a for-profit company. The exemption would not be denied, however, if the tax-exempt organization licensed the results of the research to a for-profit enterprise in consideration of an arm's length royalty consistent with its tax-exempt status.

This Article is an exception to the saving clause of paragraph 3 of Article 1 (General Scope). Thus, a Slovak student, trainee, or researcher is entitled to the benefits of this Article even if such individual becomes a resident of the United States under the "substantial presence" test of Code section 7701(b). However, the benefits of this Article are not available to a U.S. citizen or "green card" holder.

Article 22. OTHER INCOME

This Article provides the rules for the taxation of items of income not dealt with in the other articles of the Convention. This Article deals with classes of income that are not dealt with elsewhere, such as lottery winnings, punitive damages, and cancellation of indebtedness income. The article also applies to items of income that are excluded from the other articles because of their source or some other characteristic. For example, Article 11 (Interest) addresses only the taxation of interest arising in a Contracting State. Interest arising in a third state therefore is subject to the rules of Article 22.

Paragraph 1 contains the general rule that such items of income derived by a resident of a Contracting State will be taxable only in the State of residence. This exclusive right of taxation applies irrespective of whether the residence State exercises its right to tax the income.

Paragraph 2 contains an exception to the general rule of paragraph 1 for income (other than income from real property) that is attributable to a permanent establishment or fixed base that is or was maintained in a Contracting State by a resident of the other Contracting State. The taxation of such income is governed by the provisions of Articles 7 (Business Profits) or 14 (Independent Personal Services). Thus, in general, third-country income that is attributable to a permanent establishment maintained in the United States by a resident of Slovakia would be taxable by the United States.

There is an exception to the rule of paragraph 2 for income from real property, as defined in paragraph 2 of Article 6 (Income from Real Property (Immovable Property)). If a Slovak resident derives income from real property located outside the United States that is attributable to the resident's permanent establishment or fixed base in the United States, only Slovakia and not the United States may tax that income. This special rule for foreign situs real property is consistent with the general rule, also reflected in Articles 6 and 23 (Capital), that only the situs and residence states may tax real property and real property income. Even if such property is part of the property of a permanent establishment or fixed base in a Contracting State, that State may not tax if neither the situs of the property nor the residence of the owner is in that State.

This Article is subject to the "saving" clause of paragraph 3 of Article 1 (General Scope). Thus the United States may tax the income of a Slovak resident not dealt with elsewhere in the Convention if that Slovak resident is a citizen of the United States.

Article 23. CAPITAL

This Article specifies the circumstances in which a Contracting State may impose tax on capital owned by a resident of the other Contracting State. Since the United States does not impose a national-level tax on capital, the only capital taxes covered by the Convention are those imposed by Slovakia. Thus, although the Article is drafted in a reciprocal manner, its provisions are relevant only for the imposition of Slovak tax.

Paragraph 1 provides that capital represented by real property (as defined in Article 6 (Income from Real Property) (Immovable Property)) that is owned by a resident of a Contracting State and situated in the other Contracting State may be taxed in the situs state. Thus, real property owned by a U.S. resident and located in Slovakia may be taxed by Slovakia.

Paragraph 2 provides the same rule for movable property that is part of the business property of a permanent establishment or

fixed base that an enterprise or resident of a Contracting State has in the other Contracting State. Thus, movable property that is part of the business property of a permanent establishment or fixed base that a U.S. enterprise or resident maintains in Slovakia may be taxed in Slovakia.

The taxing right granted to the situs State under paragraphs 1 and 2 is not an exclusive right; in both cases, the State of residence may also tax. As noted above, the United States does not impose a capital tax. The Article does not preclude Slovakia, however, from imposing its capital tax with regard to real or immovable property owned by a Slovak resident and located in the United States.

Paragraph 3 provides that capital represented by ships, aircraft or containers owned by a resident of one Contracting State and operated in international traffic may be taxed only in the residence State. This rule is consistent with the rule of Article 8 (Shipping and Air Transport) that addresses the income from international transportation activities.

Paragraph 4 provides that all other items of capital of a resident of a Contracting State shall be taxable only in the residence State.

Article 24. RELIEF FROM DOUBLE TAXATION

In this Article, each Contracting State undertakes to relieve double taxation by granting a foreign tax credit against its income tax for the income tax paid to the other country. Under paragraph 1, the credit granted by the United States is allowed in accordance with the provisions and subject to the limitations of U.S. law, as that law may be amended over time, so long as the general principle of this Article (the allowance of a credit) is retained. Thus, although the Convention provides for a foreign tax credit, the terms of the credit are determined by the provisions of the U.S. statutory credit, at the time the credit is given.

The U.S. foreign tax credit is generally limited under the Code to the amount of U.S. tax due with respect to net foreign source income within the relevant foreign tax credit limitation category (see Code section 904(a)). Nothing in the Convention prevents the limitation of the U.S. credit from being applied on a per-country or overall basis or some variation thereof. In general, where source rules are provided in the Convention for purposes of determining the taxing rights of the Contracting States, these are consistent with the Code source rules for foreign tax credit and other purposes. Where, however, there is an inconsistency between Convention and Code source rules, the Code source rules (e.g., Code section 904(g)) will be used to determine the limits for the allowance of a credit under the Convention.

(Paragraph 3 of the Article provides an exception to this general rule with respect to certain U.S. source income of U.S. citizens resident in Slovakia.)

Paragraph 2 provides that Slovakia may include in the income tax base of its residents items of income that, under the Convention, are also taxable by the United States. Slovakia will credit the U.S. tax paid on such income to the extent that such tax does not exceed the amount of Slovak tax that is appropriate to the income.

Paragraph 3 provides a special rule for the tax treatment of U.S. citizens resident in Slovakia. Under this paragraph, income that may be taxed by the United States solely by reason of citizenship in accordance with the "saving" clause of paragraph 3 of Article 1 (General Scope) shall be treated as having its source in Slovakia to the extent necessary to avoid double taxation. This provision overrides U.S. law source rules only in those cases where U.S. law would operate to deny a foreign tax credit for taxes imposed by Slovakia under the provisions of the Convention on U.S. citizens resident in Slovakia. In no case, however, is this provision to reduce the taxes paid to the United States below the amount that would be paid if the individual were not a citizen of the United States, i.e., the U.S. tax imposed on a nonresident, non-citizen with respect to income arising in the United States.

As an example of the application of paragraph 3, consider a U.S. citizen resident in Slovakia who receives $200 of portfolio dividend income from United States sources and is subject to U.S. tax at 28 percent ($56) on that income. Under the provisions of Article 10 (Dividends), the United States tax on portfolio dividends paid to residents of Slovakia who are not U.S. citizens is limited to 15 percent ($30 in this case). Suppose Slovakia taxes that income of its resident at 40 percent, or $80, and grants, in accordance with the provisions of paragraph 2 of this Article, a credit for the $30 of U.S. tax imposed on the basis of source only. The net Slovak tax will be $50 and the total tax $106. Thus, the total tax is higher than either of the two countries' taxes, indicating some double taxation. The United States agrees to resource enough of that dividend income to avoid double taxation, but in no case, to reduce the U.S. tax paid below the $30 it is entitled to tax at source. In this example, the U.S. will resource enough of the dividend to permit a credit of $26, thus reducing its net tax from $56 to $30. The total tax becomes $80 ($50 + 30), the higher of the two taxes, and double taxation is eliminated. (The need for such a resourcing provision arises only if the Slovak tax exceeds the applicable U.S. tax and the Slovak credit permitted under its law and the treaty is limited to the U.S. tax imposed under the treaty on residents of Slovakia who are not U.S. citizens.)

By reason of paragraph 4(a) of Article 1 (General Scope), Article 24 is not subject to the provisions of the "saving" clause of paragraph 3 of Article 1. Thus, the "saving" clause cannot be used to deny a Slovak resident the benefit of the credits provided for in paragraph 1 or to deny a U.S. citizen or resident the benefit of the credits provided for in paragraphs 2 and 3.

Article 25. NON-DISCRIMINATION

This Article ensures that nationals, enterprises and residents of a Contracting State will not be subject to discriminatory taxation in the other Contracting State. For this purpose, non-discrimination means providing national treatment.

Paragraph 1 provides that a national of one Contracting State may not be subject to taxation or any connected requirement in the other Contracting State that is different from or more burdensome than the taxation and connected requirements imposed upon a national of that other State in the same circumstances. A national of a Contracting State is afforded protection under this paragraph even if the national is not a resident of either Contracting State. Thus, a U.S. citizen who is resident in a third country is entitled, under this paragraph, to the same treatment in Slovakia as a Slovak national who is in similar circumstances. It is understood, however, that for U.S. tax purposes, a U.S. citizen who is resident outside the United States, whether in Slovakia or a third country, is not in the same circumstances as a national of Slovakia who is a resident outside the United States, because the U.S. citizen is subject to U.S. tax on his worldwide income while the Slovak national is subject to U.S. tax only on his U.S. source income.

Paragraph 2 defines the term "nationals" to mean all individuals possessing the nationality of a Contracting State and all legal persons, partnerships and associations deriving their status as such from the laws in force in a Contracting State. The term includes citizens of a Contracting State.

Paragraph 3 of the Article provides that a permanent establishment in a Contracting State of a resident of the other Contracting State may not be less favorably taxed in the first-mentioned State than an enterprise of that first-mentioned State that is carrying on the same activities. This provision, however, does not oblige a Contracting State to grant to a resident of the other Contracting State any tax allowances, reliefs, etc., that it grants to its own residents on account of their civil status or family responsibilities. Thus, if an individual resident in Slovakia owns a Slovak enterprise that has a permanent establishment in the United States, in assessing income tax on the profits attributable to the permanent establishment, the United States is not obligated to allow to the Slovak resident the

personal allowances for himself and his family that he would be permitted to take if the permanent establishment were a sole proprietorship owned and operated by a U.S. resident.

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

Paragraph 4 of the Article specifies that no provision of the Article will prevent either Contracting State from imposing the branch tax described in paragraph 6 of Article 10 (Dividends).

Paragraph 5 prohibits discrimination in the allowance of deductions. When a resident of a Contracting State pays interest or royalties or makes other disbursements to a resident of the other Contracting State, the first-mentioned Contracting State must allow a deduction for those payments in computing the taxable profits of the enterprise under the same conditions as if the payment had been made to a resident of the first-mentioned State. An exception to this rule is provided for cases where the provisions of paragraph 1 of Article 9 (Associated Enterprises), paragraph 6 of Article 11 (Interest) or paragraph 5 of Article 12 (Royalties) apply, because all of these provisions permit the denial of deductions in certain circumstances in respect to excessive (not at arm's length) payments between related persons. The term "other disbursements" is understood to include a reasonable allocation of executive and general administrative expenses, research and development expenses and other expenses incurred for the benefit of a group of related persons that includes the person incurring the expense.

Paragraph 5 also provides that any debts of a resident of a Contracting State to a resident of the other Contracting State are deductible in the first-mentioned Contracting State in computing taxable capital under the same conditions as if the debt had been contracted to a resident of the first-mentioned State. At present, only Slovakia imposes a capital tax. However, this Article also

applies to taxes imposed by political subdivisions and local authorities of Slovakia and to state and local taxes in the United States. (See discussion of paragraph 7.) Thus, if such a tax is imposed on the value of real property net of debt, the same deduction must be allowed with respect to debt of creditors who are residents of either Contracting State.

Paragraph 6 requires that a Contracting State not impose other or more burdensome taxation or connected requirements on a company that is a resident of that State, and that is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, than the taxation or connected requirements that it imposes on similar resident companies owned by residents of the first-mentioned State. It is understood that the rules of Code section 367(e)(2) regarding liquidating distributions of appreciated property by a U.S. subsidiary to a foreign parent corporation, the provision in Code section 1446 for withholding of tax on distributions to non-U.S. partners (discussed above), and the rule of Code section 1361 under which nonresident alien individuals are ineligible to become shareholders of subchapter S corporations, do not violate the provisions of this Article.

Paragraph 7 provides that, notwithstanding the specification of taxes covered by the Convention in Article 2 (Taxes Covered), for purposes of providing nondiscrimination protection this Article applies to taxes of every kind and description imposed by a Contracting State or a political subdivision or local authority thereof. Customs duties are not considered to be taxes for this purpose.

The "saving" clause of paragraph 3 of Article 1 (General Scope) does not apply to this Article, by virtue of the exceptions in paragraph 4(a) of Article 1. Thus, for example, a U.S. citizen who is resident in Slovakia may claim benefits in the United States under this Article.

Article 26. MUTUAL AGREEMENT PROCEDURE

This Article provides for cooperation between the competent authorities of the Contracting States to resolve disputes that may arise under the Convention and to resolve cases of double taxation not provided for in the Convention. The competent authorities of the two Contracting States are identified in subparagraph 1(g) of Article 3 (General Definitions).

Paragraph 1 provides that, where a person considers that the actions of one or both Contracting States result or will result for him in taxation that is not in accordance with the Convention, he may present his case to the competent authority of his State of residence or citizenship. The case must be presented within three

years from the first notification of the action resulting in taxation not in accordance with the Convention. It is not necessary for a person first to have exhausted the remedies provided under the national laws of the Contracting States before presenting a case to the competent authorities.

Paragraph 2 provides that, if the competent authority of the Contracting State to which the case is presented considers the case to have merit, and if it cannot reach a satisfactory solution unilaterally, it will seek agreement with the competent authority of the other Contracting State to avoid taxation not in accordance with the Convention. Any agreement reached under this provision is to be implemented even if implementation would be otherwise barred by the statute of limitations or by some other procedural limitation, such as a closing agreement. Because, as specified in paragraph 2 of Article 1 (General Scope), the Convention cannot operate to increase a taxpayer's liability, time or other procedural limitations can be overridden only for the purpose of making refunds and not to impose additional tax.

Paragraph 3 authorizes the competent authorities to seek to resolve difficulties or doubts that may arise as to the application or interpretation of the Convention. It is intended that the competent authorities may agree, for example, to the same attribution of income, deductions, credits or allowances between a resident of one Contracting State and its permanent establishment in the other; to the allocation of income, deductions, credits or allowances between persons; or to settle a variety of conflicting applications of the Convention, including those regarding the characterization of items of income or of persons, the application of source rules to particular items of income, differences in meanings of a term, and differences in applying penalties, fines and interest. Agreements reached by the competent authorities under this paragraph need not conform to the internal law provisions of either Contracting State.

Paragraph 3 also authorizes the competent authorities to address double taxation in cases not provided for in the Convention, but with respect to taxes covered by the Convention. An example might be double taxation arising from a transfer pricing adjustment between two permanent establishments of a third-country resident, one in the United States and the other in Slovakia. Since no resident of a Contracting State is involved in the case, the Convention does not, by its terms, apply. The competent authorities may, nevertheless, use the authority of the Convention to seek to prevent double taxation.

Paragraph 4 authorizes the competent authorities to communicate with each other directly for these purposes. It is not necessary to communicate through diplomatic channels.

The benefits of this Article are also available to residents or citizens of either Contracting State under paragraph 4(a) of Article 1 (General Scope). Thus, rules, definitions, procedures, etc., that are agreed upon by the competent authorities under this Article may be applied by the United States with respect to its citizens and residents, even if those rules etc. differ from the comparable Code provisions. Similarly, U.S. law may be overridden to provide refunds of tax to a U.S. citizen or resident under this Article.

Article 27. EXCHANGE OF INFORMATION AND ADMINISTRATIVE ASSISTANCE

This Article provides for the exchange of information between the competent authorities of the Contracting States. The information to be exchanged is that necessary for carrying out the provisions of the Convention or the domestic laws of the United States or Slovakia concerning the taxes covered by the Convention. For purposes of this Article, the taxes covered by the Convention include all taxes imposed at the national level. Exchange of information with respect to domestic law is authorized insofar as the taxation under those domestic laws is not contrary to the Convention. Thus, for example, information may be exchanged with respect to any national level tax, even if the transaction to which the information relates is a purely domestic transaction in the requesting State.

Paragraph 1 states that information exchange is not restricted by Article 1 (General Scope). This means that information may be requested and provided under this Article with respect to persons who are not residents of either Contracting State. For example, if a third-country resident has a permanent establishment in Slovakia that engages in transactions with a U.S. resident, the United States could request information with respect to that permanent establishment, even though it is not a resident of either Contracting State. Such information would not be routinely exchanged, but may be requested in specific cases.

Paragraph 1 also provides assurances that any information received in accordance with this Article will be treated as secret, subject to the same disclosure constraints that apply to information obtained under the laws of the requesting State. Information received may be disclosed only to persons, including courts and administrative bodies, concerned with the assessment, collection, enforcement or prosecution in respect of the taxes to which the information relates, or to persons concerned with the administration of these taxes. The information must be used by such persons in connection with these designated functions. Persons concerned with the administration of taxes, in the United States, include the tax-writing committees of Congress and the General Accounting Office. Information received by these bodies is

for use in the performance of their role in overseeing the administration of U.S. tax laws. Information received under this Article may be disclosed in public court proceedings or in judicial decisions.

Paragraph 2 explains that the obligations undertaken in paragraph 1 to exchange information do not require a Contracting State to carry out administrative measures that are at variance with the laws or administrative practice of either State. Nor is either State obligated to supply information not obtainable under the laws or administrative practice of either State. Thus, there is no obligation to furnish information to the other Contracting State if either the requested State or the requesting State could not obtain such information for itself in a domestic case. There is also no obligation to disclose trade secrets or other information, the disclosure of which would be contrary to public policy. Either Contracting State may, however, at its discretion, subject to the limitations of the paragraph and its internal law, provide information that it is not obligated to provide under the provisions of this paragraph.

Paragraph 3 provides that, when information is requested by a Contracting State in accordance with this Article, the other Contracting State is obligated to obtain the requested information as if the tax in question were the tax of the requested State, even if that State has no direct tax interest in the case to which the request relates. The paragraph further provides that the requesting State may specify the form in which information is to be provided (e.g. depositions of witnesses and authenticated copies of original documents), so that the information can be used in the judicial proceedings of the requesting State. The requested State should provide the information in the form requested to the same extent that it can obtain information in that form under its own laws and administrative practices with respect to its own taxes.

Paragraph 4 provides that this Article applies to national taxes of every kind, notwithstanding the provisions of Article 2 (Taxes Covered).

Article 28. DIPLOMATIC AGENTS AND CONSULAR OFFICERS

This Article confirms that any fiscal privileges to which members of diplomatic or consular missions are entitled under the general provisions of international law or under special agreements will apply, notwithstanding any provisions of this Convention to the contrary. This provision also applies to residents of either Contracting State, provided that they are not citizens of that State and, in the case of the United States, are not "green card" holders. (See subparagraph 4(b) of Article 1 (General Scope.)

Article 29. ENTRY INTO FORCE

This Article provides the rules for bringing the Convention into force and giving effect to its provisions. Paragraph 1 provides for the ratification of the Convention by both Contracting States and the prompt exchange of instruments of ratification.

Paragraph 2 provides that the Convention will enter into force on the date on which instruments of ratification are exchanged. Under subparagraph 2(a), the Convention will have effect with respect to taxes withheld at source for amounts paid or credited on or after the first day of the second month next following the date of entry into force. For example, if the Convention were to enter into force on December 10, 1993, the withholding rates on dividends, interest and royalties would be reduced (or eliminated) for amounts paid on or after February 1, 1994. For all other taxes, the Convention will have effect for any taxable period beginning on or after January 1 of the year in which the Convention enters into force, i.e., 1993 in the preceding example.

Article 30. TERMINATION

The Convention is to remain in effect indefinitely, unless terminated by one of the Contracting States in accordance with the provisions of this Article. The Convention may be terminated at any time after five years from the date of its entry into force, provided that written notice has been given through diplomatic channels at least six months in advance. If such notice is given, the Convention will cease to apply in respect of taxes withheld on dividends, interest and royalties paid or credited on or after the first day of the January next following the expiration of the six-month period. The Convention will cease to apply with respect to other taxes for taxable periods beginning on or after the first day of the January next following expiration of the six-month period. Thus, for example, if notice of termination is given in July or later of a calendar year, the termination will not be effective as of the following January 1 but as of the second January 1, since the notice period must continue for at least six months.

Article 30 relates to unilateral termination by a Contracting State of the Convention. The Article does not prevent the Contracting States from entering into a new bilateral agreement that supersedes, amends or terminates provisions of the Convention, either prior to the expiration of the five-year period or without the six-month notification period.