UNITED STATES TREASURY DEPARTMENT
TECHNICAL EXPLANATION OF THE CONVENTION BETWEEN
THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND
THE GOVERNMENT OF THE TUNISIAN REPUBLIC
FOR THE AVOIDANCE OF DOUBLE TAXATION AND
THE PREVENTION OF FISCAL EVASION WITH RESPECT
TO TAXES ON INCOME, SIGNED AT WASHINGTON ON
JUNE 17, 1985 TOGETHER WITH A
SUPPLEMENTARY PROTOCOL SIGNED AT
TUNIS, OCTOBER 10, 1989

The Convention signed in 1985 was not considered by the U.S. Senate prior to enactment of the Tax Reform Act of 1986. A supplementary Protocol signed in 1989 amends the Convention to take into account changes in U.S. tax policy made by that Act as well as certain other changes. The negotiations took as their starting point the U.S. Treasury Department's draft Model Income Tax Convention of June, 1981 ("the U.S. Model"), and the model income tax conventions published by the Organization for Economic Cooperation and Development in 1977 ("the OECD Model") and by the United Nations in 1980 ("the U.N. Model").

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

The explanations of each article will include explanations of any Protocol provisions relating to that article.

References to "he" and "his" should be read to mean also "she" and "her".

Article 1. PERSONAL SCOPE

Article 1 states that the Convention is applicable in general to residents of the United States or Tunisia or of both countries. Residence is defined in Article 4 (Fiscal Domicile). Other articles may provide exceptions to this general rule. For example, Article 22 (General Rules) provides that each Contracting State reserves the right to tax its residents and the United States reserves the right to tax its citizens and certain former citizens, according to domestic law. Certain provisions, such as the exchange of information provided for in Article 26

(Exchange of Information and Administrative Assistance) and the source rule for interest payments provided in paragraph 6 of Article 11 (Interest), may also affect residents of third States.

Article 2. TAXES COVERED

Article 2 provides that the Convention applies to national taxes on income imposed by the Contracting States at the time of signature of the Convention and identifies the existing U.S. and Tunisian taxes to which the Convention applies. It also provides that the Convention applies to any identical or substantially similar taxes imposed subsequent to that time.

Paragraph 2 identifies the existing taxes to which the Convention applies. It was amended by Article I of the Protocol to clarify that the U.S. income taxes covered include the changes to the Internal Revenue Code made by the Tax Reform of 1986 and the technical corrections thereto, and to update the list of Tunisian income taxes by substituting the tax on industrial and commercial profits and the tax on corporations for the former reference to the business profits tax. The Convention does not apply to the United States accumulated earnings tax, the personal holding company tax, or social security taxes. The Convention does not apply to Federal taxes other than income taxes or, except as provided in Article 24 (Non-Discrimination), to any State or local taxes. For purposes of Article 24, the scope of the Convention is expanded to apply to taxes of all kinds imposed at all levels of government in the United States and Tunisia.

Paragraph 3 provides that taxes imposed after the date of signature of the Convention also are covered if they are substantially similar to the taxes referred to in paragraph 2. The competent authorities agree to advise each other of major changes in their respective income tax laws.

Article 3. GENERAL DEFINITIONS

Paragraph 1 defines the meaning of certain terms as they are used in the Convention. Unless the context otherwise requires, the defined terms have the same meaning throughout the Convention. A number of other important terms are defined in other articles. For example, see Article 4 (Fiscal Domicile), Article 5 (Permanent Establishment), and the definitions of dividends, interest, and royalties in Articles 10, 11, and 12, respectively.

The terms "person", "company", and "enterprise of a Contracting State" or "enterprise of the other Contracting State" are consistent with the definitions in the U.S. model draft income tax treaty published in June, 1981 (the "U.S. Model"). A partnership is included in the definition of a person as a body of persons.

The competent authority for the United States 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, redelegated* 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. The competent authority for Tunisia is the Minister of Finance or his representative.

Subparagraphs e) and f) of paragraph 1 define the geographical scope of the two countries to include the adjacent seas to the extent that, under international law, the respective country may exercise rights with respect to natural resources of the seabed and marine subsoil of such areas. Though not specified, the term "United States" is understood not to apply to Puerto Rico or to other U.S. possessions or territories.

The definition of international traffic is the same as in the U.S. Model. It includes any transport by a ship or aircraft except to the extent that the transport is solely between places in a Contracting State. Thus, for example, a trip which begins in Tunis, stops in New York, and continues to Chicago is international traffic except to the extent that passengers or cargo board at New York. To the extent that passengers or cargo are carried only on the New York-Chicago portion of the trip, the transport is not considered international traffic, and the substantive taxing rules of Article 8 (Shipping and Air Transport), therefore, do not apply. In such a case, the income would be taxed as business profits under Article 7, and if derived by an enterprise of Tunisia would be taxable in the United States only if attributable to a U.S. permanent establishment and then, only on a net basis. The gross basis U.S. tax (Code section 887) would not apply under these circumstances.

Paragraph 2 provides that undefined terms shall be defined according to the law of the Contracting State whose tax is being determined. However, if the meaning differs from that under the law of the other Contracting State, or if it is not readily determinable, the competent authorities may establish a common meaning for the purposes of the Convention. This common meaning need not conform to the meaning of the term under the laws of either Contracting State.

Article 4. FISCAL DOMICILE

This Article defines those persons who are residents of the United States or Tunisia for purposes of the Convention. Paragraph 1, as amended by the Protocol, begins by stating that a resident of a Contracting State means the State itself or a political subdivision or local authority thereof and any person liable to tax in that State by reason of such person's domicile, residence, place of management, place of incorporation or any other similar criterion. A U.S. citizen or an alien admitted as a permanent resident (a "green card" holder) who resides outside the United States will be considered a U.S. resident for Tunisian tax purposes only if the individual has a substantial presence, permanent home, or habitual abode in the United States. For this purpose, "substantial presence" is defined as in Code section 7701 (b). The reference to "liable to taxation" in this paragraph does not cause a tax-exempt organization to lose its status as a resident.

Although the explicit reference in the U.S. Model to partnerships was deleted in the interests of conformity with the OECD Model, it is understood that a partnership is considered a resident of a Contracting State only to the extent that the income it derives is taxed as the income of a resident of that State. This understanding applies for purposes of determining the extent to which the partnership is entitled to treaty benefits with respect to the income which it receives from the other Contracting State and the extent to which a resident of the other Contracting State is entitled to treaty benefits with respect to income paid by such person.

A person who is a resident of only one of the Contracting States under their respective taxation laws need look no further than paragraph 1. Paragraphs 2 and 3 address cases of dual residence.

If an individual is considered a resident of both States under their respective domestic laws, paragraph 2 provides a series of "tie breakers" to assign a single residence for purposes of the Convention. The first test is where the individual has a permanent home, i.e. where he resides with his family. If the individual has a permanent home in both States, he is deemed to be a resident of the State with which his personal and economic relations are closer. If that test is inconclusive, or if he does not have a permanent home in either State, the deciding factor is where he has a habitual abode. If the individual has a habitual abode in both States or in neither of them, he is deemed to be a resident of the State of which he is a national. If nationality fails to assign a single residence, the competent authorities are charged with settling the question.

Once an individual is determined to be a resident of a Contracting State under paragraph 1 or 2, that definition of residence prevails for all purposes of the Convention, including the "saving clause" of Article 22 (General Rules).

Paragraph 3 provides that, where a person other than an individual is a resident of both Contracting States, the competent authorities will attempt to agree on a single residence. Tunisia's standard of residence for companies is based on the place of effective management.

Article 5. PERMANENT ESTABLISHMENT

The rules governing the taxation by a Contracting State of business income derived by a resident of the other State utilize the concept of a "permanent establishment". Paragraph 1 of this Article defines that concept in general terms, and the following paragraphs give some specific illustrations.

Paragraph 2 identifies a place of management, a branch, an office, a factory, a workshop, and a place of extraction, such as a well or quarry, as examples of a permanent establishment.

Paragraph 3 provides that certain activities constitute a permanent establishment if they are carried on for more than a specified period of time. A building site, a construction project, an assembly or installation project, or an installation, rig or ship used in exploration or development of natural resources will be considered a permanent establishment if the site, project, or activity continues for more than 183 days in any 365 day period. Supervisory activities connected with such a site, project, or activity are taken into account in measuring the 183 day period. These time thresholds are meant to be applied as explained in the commentaries to the OECD and UN model draft income tax Conventions. In each case the 183 day period begins when the enterprise first begins work at the construction or drilling site or assembly or installation project, or when a supervisor begins work at such a site or project. Temporary interruptions of work, for example, due to weather or supply shortages, do not stop the running of the time period. Each site or project is considered separately. Paragraph 3 is similar, in its scope and time threshold, to paragraph 3(a) of Article 5 of the U.N. model.

Paragraph 4 enumerates certain activities which may be undertaken in a Contracting State by a resident of the other Contracting State without creating a permanent establishment. Those activities, (described in subparagraphs (a) through (e)), include using facilities or maintaining a stock of goods solely for the purposes of storage, display, or delivery of goods belonging to the enterprise; maintaining goods belonging to the resident solely for the purposes of processing by another person; maintaining a fixed place of business solely for the purpose of purchasing goods or collecting information for the resident; and maintaining a fixed place of business solely for preparatory or auxiliary activities of the resident, such as advertising, supplying information, or scientific research. Under subparagraph (f), these activities may be carried on in combination as long as the overall activity remains preparatory or auxiliary to the principal activities of the enterprise. The limitation contained in subparagraph (f) relating to the preparatory or auxiliary character of a combination of activities is a departure from the U.S. Model, but it is consistent with the OECD and

U.N. models and has been included in some other U.S. treaties, especially with developing countries.

Paragraphs 5 and 6 describe the permanent establishment implications of employees and agents. An independent agent, as explained in paragraph 6, does not constitute a permanent establishment of the enterprise(s) using his services. Paragraph 5 provides that a person other than an independent agent who acts in one of the Contracting States on behalf of a resident of the other State is considered a permanent establishment of that resident if he habitually concludes contracts for the resident, unless his activities are limited to those described in paragraph 4 as not constituting a permanent establishment.

Paragraph 7 states that control of one company by another does not of itself cause either company to be a permanent establishment of the other.

Paragraph 8 provides a special rule for insurance companies. It comes from the UN model and was included at the request of Tunisia. An insurance company which is a resident of one of the Contracting States and which receives premiums from or insures risks in the other State through a person other than an independent agent described in paragraph 5 is considered to have a permanent establishment in the other State; thus, such a person constitutes a permanent establishment of the insurance company even though he does not have the authority to conclude contracts on its behalf.

Article 6. INCOME FROM REAL PROPERTY

This Article provides that income of a resident of a Contracting State derived from real property situated in the other Contracting State may be taxed in the Contracting State where such property is situated. This rule applies to income from the leasing or use in any form of real property, including income from agriculture or forestry. It applies to income from immovable property of an enterprise or income from such property which is used for the performance of independent personal services.

The term "real property" is defined under the law of the Contracting State in which the property is situated. However, it includes livestock and equipment used in agriculture or forestry and rights with respect to the extraction of minerals and other natural resources. Income on indebtedness secured by immovable property or by a right giving rise to income from the extraction of natural resources is not considered income from immovable property. Such income is treated as interest subject to the provisions of Article 11 (Interest).

This Article does not prescribe the manner in which real property income is to be taxed by the State of source. United States law permits taxation on a net basis. Tunisia taxes on a net basis where the accounts permit determination of the net income; in other cases the tax may be imposed on a calculated basis of gross receipts less specified expenses.

Income from immovable property may also be taxed in the Contracting State of which the beneficial owner is a resident or citizen in accordance with paragraph 2 of Article 22 (General Rules), subject to relief from double taxation in accordance with Article 23 (Relief from Double Taxation).

Article 7. BUSINESS PROFITS

This Article provides rules for the taxation by a Contracting State of income from business activity carried on by a resident of the other State.

Paragraph 1 provides that the business profits of a resident of a Contracting State shall be taxable only by that State unless the resident carries on or has carried on business through a permanent establishment in the other Contracting State.

Article III of the Protocol contains an understanding of the Contracting States regarding the implementation of this Article and related provisions of Articles 10 (Dividends), 11 (Interest), 12 (Royalties), 13 (Capital Gains), 14 (Independent Personal Services), and 21 (Other Income). The Protocol incorporates the principle of Code section 864(c)(6) into the Convention. Any income or gain attributable to a permanent establishment (or, in the context of Articles 10, 11, 12, 13, 14 and 21, a fixed base as well) during its existence is taxable in the Contracting State where the permanent establishment (or fixed base) is situated even if the payments are deferred until after the permanent establishment (or fixed base) no longer exists.

Paragraph 2 provides that the profits to be attributed to the permanent establishment are those which it might be expected to make if it were an independent entity engaged in the same or similar activities under the same or similar conditions and dealing on an arm's length basis with its home office and with any other associated enterprises. The term "attributable to" means that the limited "force-of-attraction" rule of Code section 864(c)(3) does not apply for U.S. tax purposes under the Convention. Profits may, however, be from sources within or without a Contracting State and be "attributable to" a permanent establishment. Thus, for example, items of income described in section 864(c)(4)(B) of the Code which are attributable to a permanent establishment in the United States are subject to tax by the United States.

Paragraph 3 provides that deductions shall be allowed of expenses incurred for the purposes of the permanent establishment, whether incurred in the State where the permanent establishment is located or elsewhere. Deductible expenses include a reasonable allocation to the permanent establishment of general overhead expenses, including administrative and executive expenses. This provision was taken from the OECD Model. It is understood that this rule overrides Tunisia's statutory limitation of such overhead expense deductions. The paragraph adds the provision of the U.N. model that payments of interest, royalties, fees and commissions by a permanent establishment to its home office are not deducted in determining the profits of the permanent establishment except to the extent that they represent reimbursement of costs incurred.

Paragraph 4 provides that the mere purchase by a permanent establishment of goods or merchandise for the resident of which it is a permanent establishment shall not result in profits being attributed to the permanent establishment.

Paragraph 5 provides that the method of determining profits attributable to a permanent establishment shall not be changed from year to year unless there is good and sufficient reason for such a change.

Paragraph 6 provides that, where business profits include items of income dealt with separately in other articles of the Convention, the provisions of those separate articles override the provisions of this Article. Thus, for example, the taxation of income from international shipping and air transport is dealt with in Article 8 (Shipping and Air Transport). The taxation of dividends, interest, and royalties is controlled by Articles 10 (Dividends), 11 (Interest), and 12 (Royalties); however, those Articles provide that where the assets giving rise to dividends, interest, or royalties derived by a resident of a Contracting State are effectively connected with a permanent establishment or fixed base of that resident in the other Contracting State, the resulting income is taxable on a net basis in accordance with this Article or Article 14 (Independent Personal Services).

Paragraph 7 is a special rule, inserted at the request of Tunisia, to make it clear that Tunisia may tax the participants in a Tunisian joint venture on their shares in the profits of the joint venture.

Paragraph 8 was inserted at the request of Tunisia to permit the tax authorities of a Contracting State to apply the provisions of internal law in determining tax liability in cases where the information available to the competent authority is not adequate to measure accurately the profits of a permanent establishment. The Internal Revenue Service would have this power even in the absence of such a specific provision. The determination of profits in such cases, based on the available information, must be done consistently with the principles of this Article, i.e., it must seek to reflect arm's length pricing and appropriate deductions of expenses.

Article 8. SHIPPING AND AIR TRANSPORT

Paragraph 1 limits the right of a Contracting State to tax income derived by an enterprise from the operation of ships or aircraft in international traffic. Tunisia may tax only if the effective management of the enterprise is in Tunisia (or, if the effective management is on board a ship which either has its home harbor in Tunisia or, if the home harbor is not known, is operated by a resident of Tunisia); these rules come from the OECD model. The United States may tax only if the enterprise is created under U.S. law. In effect, a Contracting State may tax such income only if the enterprise is a resident of that State for tax purposes under domestic law. A dual resident company may be taxed by both States, subject to relief from double taxation in accordance with Article 23 (Relief from Double Taxation). "International traffic" is defined in Article 3 (General Definitions). This Article takes precedence over Article 7 (Business Profits). Thus, each State must exempt a resident of the other State even if the income is attributable to a permanent establishment in the first State.

Paragraph 2 defines the scope of income eligible for the exemption. Income from the operation of ships or aircraft in international traffic is defined to include income from the rental on a full or bareboat basis of ships or aircraft used in international traffic, if either the ship or aircraft is used in international traffic by the lessee or the rental income is occasional and accessory to operating income. Income derived from the use, maintenance, or leasing of containers and related equipment used in international traffic is covered by this Article if the income is occasional and accessory to income described in paragraph 1, i.e., if the resident deriving the income is engaged in international shipping or aircraft operations and the container leasing activity is relatively minor in relation to those operations. Income from the leasing of containers by leasing companies not engaged in international shipping or air transport is covered by Articles 7 (Business Profits) or 14 (Independent Personal Services), which provide for taxation at source only to the extent that the income is attributable to a permanent establishment or fixed base.

Paragraph 3 provides that the provisions of paragraph 1 also apply to profits from participation in a pool or other joint business engaging in international shipping or air transport. Thus, for example, if a Tunisian and an Algerian airline participate in a joint venture which flies to the United States, the share of profits derived by the Tunisian airline would be exempt from U.S. tax under this provision. As with any benefit of the Convention, the enterprise claiming the benefit must be entitled to it under the provisions of paragraphs 5, 6 and 7 of Article 25 (Mutual Agreement Procedure) as added by the Protocol.

Article 9. ASSOCIATED ENTERPRISES

This Article complements section 482 of the Code and confirms the right of the Contracting States to reallocate income in certain cases. Under paragraph 1, if conditions between associated enterprises in their commercial or financial relations differ from those that would be made between independent enterprises, any profits that would, but for those conditions, have accrued to one of the enterprises, but by reason of those conditions have not so accrued, may be included in the profits of that enterprise and taxed accordingly. This rule applies in cases 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 the same persons participate directly or indirectly in the management, control, or capital of both.

Paragraph 2 describes the consequences of an adjustment made by a Contracting State in accordance with paragraph 1. Where a Contracting State makes such an adjustment, the other Contracting State shall make an appropriate adjustment to the amount of tax which it charged the associated enterprise, in order to avoid double taxation. It is implicit in the language of the paragraph that the other Contracting State agrees that the adjustment reflects the result which would occur under arm's length conditions. In determining the amount of such adjustments, other provisions of the Convention are to be taken into account. Thus if, as a result of the adjustment, one enterprise is determined to have made a distribution of profits to the other, the provisions of Article 10 (Dividends) may apply to the deemed distribution. If necessary, the competent authorities shall consult to resolve any differences in the application of these provisions.

If an adjustment is made under paragraph 2 of this Article the correlative adjustment made by the other Contracting State is to be implemented pursuant to paragraph 2 of Article 25 (Mutual Agreement Procedure), notwithstanding any time limits in the domestic law of the Contracting States. The saving clause of paragraph 2 of Article 22 (General Rules) 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 subparagraph 1 of Article 22, the Convention cannot restrict any statutory benefit.

It is understood that this Article does not limit the application of any internal law provisions in either Contracting State designed to place transactions between related enterprises on an arm's-length basis. Thus, it does not limit the right of the United States to apply section 482 of the Code.

Article 10. DIVIDENDS

This Article governs the taxation by a Contracting State of dividends paid by a company which is a resident of that State to a resident of the other Contracting State. It also governs the application of branch taxes imposed in addition to the tax on profits.

Dividends may be taxed in both Contracting States, in the country of source and the country of residence. Under paragraph 2 of this Article, the tax imposed by the State of source may not exceed 14 percent of the gross amount of the dividends when the beneficial owner is a company which owns, directly, at least 25 percent of the share capital of the distributing company. The tax at source in other cases may not exceed 20 percent of the gross amount of the dividends. These limitations are subject to the exceptions in paragraph 3. (Further, under paragraph 2 of Article 22 (General Rules) these limitations do not apply to the U.S. taxation of U.S. citizens and persons who, under Article 4 (Fiscal Domicile) are U.S. residents.)

Paragraph 3, as added by the Protocol, addresses the taxation of dividends paid by certain U.S. "pass-through" entities. Dividends paid by a U.S. Regulated Investment Company are taxable at source at not more than 20 percent of the gross amount, in accordance with subparagraph (b) of paragraph 2. Dividends paid by a U.S. Real Estate Investment Trust are taxable at source at not more than 20 percent of the gross amount if the beneficial owner is an individual resident of Tunisia owning an interest of less than 25 percent in the Real Estate Investment Trust; in other cases dividends paid by such entities are subject to tax in accordance with domestic law.

Paragraph 4 (as renumbered by the Protocol) adopts the definition of "dividends" found in the OECD Model. It adds a provision which permits either Contracting State to treat as dividends other claims, including debt obligations, which carry the right to participate in profits, to the extent consistent with domestic law.

Paragraph 5, as renumbered and amended by Articles III and IV of the Protocol, provides that this Article does not apply if the shareholding giving rise to the dividends is effectively connected with a permanent establishment or fixed base which the owner of the dividends has or had in the Contracting State of which the distributing corporation is a resident. In such a case the dividends are taxable to the permanent establishment or fixed base in accordance with Article 7 (Business Profits) or Article 14 (Independent Personal Services), as appropriate.

Paragraph 6, as renumbered by the Protocol, provides that a Contracting State may not tax dividends paid by a company which is a resident of the other Contracting State except to the extent that the dividends are paid to a resident of the first State or that the shareholding is effectively connected with a permanent establishment or fixed base in the first State. The right to tax in those two cases derives from paragraph 2 of Article 22 (General Rules) and paragraph 5 of this Article, respectively.

Paragraph 7, added by the Protocol, replaces prior paragraph 6, which authorized the imposition of a branch profits tax by Tunisia, to also permit the imposition of the U.S. branch taxes enacted by the Tax Reform Act of 1986. Under paragraph 7, each Contracting State may impose on a resident of the other State a tax in addition to the corporate level tax on the profits of a permanent establishment in the first-mentioned State and on income or gains derived with respect to real property situated in the first-mentioned State. The tax base is defined in accordance with domestic laws, but must be net of the corporate level tax. In the United States, the branch profits tax base is the "dividend equivalent amount" as defined in Code section 884(b), which is roughly the amount that would be distributed as a dividend if the U.S. permanent establishment were operating as a locally incorporated subsidiary. Under the Convention, the dividend equivalent amount is determined taking into account not only effectively connected profits (or profits that are deemed to be effectively connected) that are attributable to a permanent establishment in the United States but also profits from the disposition or operation of real estate that are subject to net basis taxation in the United States under Article 6 (Income from Real Property) or Article 13 (Capital Gains).

The Contracting States may also impose a tax on excess interest. Under section 884(f)(1)(B), excess interest is the excess of the total amount allowable as a deduction in computing the U.S. effectively connected income of a foreign corporation over the total interest paid by the foreign corporation's U.S. trade or business. Under the Convention, the U.S. tax on excess interest applies only to the excess of interest which is deductible in computing net U.S. tax on (1) profits that are attributable to a U.S. permanent establishment of a resident of Tunisia or (2) income or gains derived by a resident of Tunisia with respect to real property situated in the United States, over the interest paid with respect to these amounts. The reference to excess interest "allocable" to the permanent establishment means any excess of interest deductible over interest paid as determined under U.S. law.

The additional taxes are limited to a rate of not more than 14 percent, reciprocally. In the absence of the Convention, the U.S. tax would be imposed at 30 percent in both cases. The Tunisian tax would be the corporate tax rate times the portion of distributions by the home office deemed to be paid out of profits of the Tunisian permanent establishment (comparable to the "dividend equivalent amount" of U.S. law); there is not currently a Tunisian tax on excess interest.

Article 11. INTEREST

This Article governs the taxation by a Contracting State of interest derived from sources within that State by a resident of the other Contracting State. The taxation of certain excess interest of a permanent establishment or trade or business is covered by paragraph 7 of Article 10 (Dividends).

Such interest may be taxed by both Contracting States, the country of source and the country of residence. However, paragraph 2 limits the tax at source to not more than 15 percent of the gross interest when the beneficial owner of the interest is a resident of the other State. Notwithstanding this limitation, however, the saving clause of paragraph 2 of Article 22 (General Rules) permits the United States to tax its citizens and persons who under Article 4 (Fiscal Domicile) are U.S. residents as if the Convention had not come into force.

Paragraph 3 provides an exemption from tax at source in certain cases. Neither Contracting State may tax interest beneficially owned by the other Contracting State or its political subdivisions or local authorities or by any agency or instrumentality thereof which is exempt from income tax in that other State. In addition, interest beneficially owned by a financial institution of the other State with respect to loans of at least 7 years duration, and interest paid by the Government of Tunisia or a political authority thereof on loans to it by a U.S. resident are exempt from tax at source. In the absence of the Convention, there would generally be no U.S. tax on portfolio interest or on interest derived by the Government of Tunisia which is exempt under section 892 of the Internal Revenue Code, and a 30 percent tax would be withheld on other interest. The Tunisian statutory rate of tax on interest paid to nonresidents is generally 15 percent (reduced from 20 percent by 1990 tax reforms.)

The definition of "interest" in paragraph 4 is substantially the same as that in the U.S. Model. It is amended to provide, by cross-reference to Article 10 (Dividends), that in certain cases obligations designated as debt may be treated as giving use to dividends if domestic law so provides. Thus, for example, income from a debt obligation carrying the right to participate in profits is not covered by Article 11 to the extent characterized as a dividend under the laws of the Contracting State in which the income arises.

Paragraph 5 provides that this Article does not apply if the indebtedness giving rise to the interest is effectively connected with a permanent establishment or fixed base which the owner of the interest has or had (See Article III of the Protocol) in the State where the interest has its source. In such a case the interest is taxable to the permanent establishment or fixed base in accordance with the provisions of Article 7 (Business Profits) or 14 (Independent Personal Services), as appropriate.

Paragraph 6 defines the source of interest payments for purposes of this Article. Interest is deemed to arise in a Contracting State if paid by a resident of that State. However, interest which is borne by a permanent establishment or fixed base in a Contracting State, whether of a resident of the other Contracting State or of a third State, is deemed to arise in the State where the permanent establishment or fixed base is situated. This rule applies where the interest paid was incurred in connection with the permanent establishment or fixed base. The reference to the indebtedness being "connected" with such permanent establishment or fixed base does not imply any requirement that the interest be traced to specific debt.

Paragraph 7 provides that, where interest paid to a related person exceeds the amount which would be paid to an unrelated person, the excess amount is not affected by this Article, but may be taxed by each Contracting State in accordance with its law, including other provisions of the Convention which may be applicable. For example, if the excess payment is characterized as a dividend, the provisions of Article 10 (Dividends) would be applicable.

Article 12. ROYALTIES

This Article governs the taxation by a Contracting State of royalties derived from sources within that State by a resident of the other Contracting State.

Such royalties may be taxed by both Contracting States, the country of source and the country of residence. However, paragraph 2, as amended by Article VI the Protocol, limits the tax at source when the beneficial owner of the royalties is a resident of the other State. The limits are 10 percent of the gross payment for the rental of equipment and of remuneration for certain technical or economic studies or technical assistance services, and 15 percent of the gross payment in other cases. In the absence of the Convention, the Tunisian statutory rate of withholding on royalties paid to nonresidents would be 21 percent (the corporate tax rate of 35 percent, as reduced by the 1990 tax reforms, applied to 60 percent of the gross payment), and the U.S. rate, 30 percent. The limitations provided in this paragraph do not apply to the U.S. taxation of U.S. citizens and persons who under Article 4 (Fiscal Domicile) are U.S. residents. (See paragraph 2 of Article 22 (General Rules)).

The 10 percent maximum rate applies to payments for the use of, or right to use, industrial, commercial or scientific equipment, other than payments for the rental of ships, aircraft or containers which are either exempt from tax under domestic law or under Article 8 (Shipping and Air Transport) or are taxable on a net basis under Articles 7 (Business Profits) or 14 (Independent Personal Services). The 10 percent maximum rate also applies to remuneration derived by a resident of a Contracting State for (1) technical or economic studies paid for out of public funds by the other Contracting State or a political subdivision or local authority thereof and (2) the performance of accessory technical services related to the use of property or rights giving rise to a royalty under this paragraph if the services are performed in the Contracting State where the payment is sourced. For example, if the Government of Tunisia contracts with a U.S. resident to provide it a technical study of a water storage system or a plan to control erosion, the remuneration for that study may be taxed by Tunisia as a royalty, at a rate of not more than 10 percent of the gross payment, without regard to where the work is done. To the extent that the study is done in the United States, the source rule of paragraph 6 permits the Tunisian tax to be claimed as a credit. In the case of remuneration for accessory technical services, a Contracting State may tax a resident of the other State only on income for services performed in the first State in connection with a right or property used there. For example, if a U.S. manufacturer grants rights to an exclusive manufacturing process to a Tunisian company and, as part of that arrangement, sends a consultant to Tunisia to train the licensees of the process in how to use it effectively, the consultant's remuneration may be taxed by Tunisia as a royalty at a rate of not more than 10 percent of the gross payment for the services rendered in Tunisia.

The 15 percent maximum rate applies to royalties with respect to copyrights, including film or tape rentals, and with respect to patents, designs, models, plans, secret processes or formulas, trademarks and information concerning industrial, commercial or scientific experience. It also applies to gain on the disposition of any such right or property when the amount realized is contingent on the productivity, use, or disposition of the property or right. Thus, a noncontingent payment for all rights to such property or right is not a royalty.

The treatment as royalties of payments for the leasing of equipment and for certain studies and accessory technical assistance differs from the position of the U.S. Model, in which such income constitutes business profits or personal service income. It represents a concession by the United States to the position of Tunisia which, as a developing country, seeks to preserve taxation at source of payments deducted from the Tunisian tax base and paid to nonresidents.

This Article does not apply if the property or rights giving rise to the royalty are effectively connected with a permanent establishment or a fixed base which the recipient has or had (See Article III of the Protocol) in the Contracting State where the royalty arises. In that case the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services) apply.

Paragraph 5 provides that, where a royalty to a related person exceeds the amount that would be paid to an unrelated person, Article 12 applies only to the extent of royalty payments that would have been made absent such special relationships (i.e., an arm's-length royalty payment). The excess amount is not affected by this Article but may be taxed by each Contracting State in accordance with its law, including other provisions of the Convention which may be applicable. For example, if the excess payment is characterized as a dividend, the provisions of Article 10 (Dividends) would be applicable.

Paragraph 6 defines the source of royalties as the State in which the right or property is used, or, in the case of the technical or economic studies referred to in subparagraph 3(c), the State which makes the payment.

Article 13. CAPITAL GAINS

This Article governs the taxation by a Contracting State of gains derived by a resident of the other Contracting State.

Gain on the disposition of real property situated in one of the Contracting States may be taxed by that State. Real property situated in the United States includes a United States real property interest. Thus, the United States retains its right to tax in accordance with section 897 of the Internal Revenue Code.

A Contracting State may tax gain derived by a resident of the other Contracting State from the alienation of movable property of a permanent establishment or fixed base which the recipient has in the first-mentioned State, including such gain from the alienation of the permanent establishment or fixed base. Under Article III of the Protocol, a Contracting State may also tax gain attributable to a permanent establishment or fixed base even if the payments are deferred until after the permanent establishment or fixed base no longer exists. This provision is consistent with section 864(c)(6) of the Code. However, the tax imposed by section 864(c)(7) would not apply. Nor does Tunisia impose a tax on the gain on property removed from a permanent establishment there. In particular, it is understood that neither country treats the removal from its territory of a drilling rig or similar equipment as a deemed disposition subject to tax on the accrued gain or on the recapture of depreciation deductions.

Gain on the alienation of ships, aircraft and related equipment, including containers, used in international traffic may be taxed in Tunisia only if the place of effective management of the enterprise deriving the gain is Tunisia, and by the United States only if the enterprise is created under U.S. law. This amounts to taxation only by the country of residence, but recognizes that a company could be a resident of both States if the competent authorities cannot agree on a single residence in accordance with paragraph 3 of Article 4 (Fiscal Domicile). Gain on the alienation of all other property, including corporate securities (other than stock included within the definition of a United States real property interest), may be taxed only by the Contracting State of which the alienator is a resident.

Article 14. INDEPENDENT PERSONAL SERVICES

This Article concerns the taxation of income from the performance of independent personal services by an individual who is a resident of one of the Contracting States when the services are performed in the other Contracting State. Independent personal services are, in general terms, services performed by an individual for his own account where he receives the income and bears the losses arising from the services. Generally, they include personal services performed by a self-employed individual, a sole proprietor, or a partner, but not services performed as an employee or an officer of a company. Services performed as a director of a corporation are typically independent services, except to the extent that the director is also an officer of the corporation (in which case Article 15 (Dependent Personal Services) applies, or that the remuneration constitutes a distribution of profits, in which case Article 16 (Directors' Fees) applies.

Paragraph 1 provides that an individual resident of a Contracting State who derives income from independent personal services may be taxed on such income by the other Contracting State only if the services are performed in that other State and if the individual meets one or more of three conditions: a) he is present in that other State for more than 183 days of the taxable year, or b) the income is attributable to a fixed base which the individual has in that other State, or c) the gross income for such services exceeds $7,500 during the taxable year. The State of residence (or citizenship) may also tax such income, subject to providing relief from double taxation in accordance with Article 23 (Relief from Double Taxation).

Paragraph 2 illustrates the type of services which may be covered by this Article. They include, but are not limited to, scientific, literary, artistic, educational, medical, legal, architectural, engineering and accounting services.

Article 15. DEPENDENT PERSONAL SERVICES

This Article concerns the taxation of income from the performance of personal services as an employee or company officer when the person performing the services is a resident of one of the Contracting States and the services are performed in the other Contracting State. Paragraph 1 provides that such income may be taxed in the State of residence of the recipient and, except as provided in paragraph 2, may also be taxed in the State where the services are performed.

Paragraph 2 sets forth the exceptions. The other (*i.e.*, source) State may not tax the remuneration if the individual is present in that State for not more than 183 days in the taxable year and the remuneration is paid by or on behalf of an employer who is not a resident of that State and is not borne as such or reimbursed (*i.e.*, deducted) by a permanent establishment which the employer has in that State. Restated affirmatively, if an employee or company officer who is a resident of one of the Contracting States performs services in the other Contracting State, the other State may tax the remuneration for those services if: a) the individual remains in that other State for more than 183 days in the taxable year, or b) the remuneration is paid by an employer which is a resident of that other State, or c) the remuneration is borne by a permanent establishment in that other State of a nonresident employer.

Paragraph 3 provides a special rule for persons regularly employed aboard a ship or aircraft engaged in international traffic. The effect of the rule is that the remuneration for such services is taxable only by the State of which the operator of the ship or aircraft is a resident. However, in accordance with paragraph 2 of Article 22 (General Rules of Taxation) each State reserves the right to tax its residents and citizens. Thus, a U.S. resident or citizen employed as a member of the crew of a Tunisian aircraft would be subject to U.S. tax on the remuneration for his services. A foreign tax credit would be allowed for any Tunisian income tax paid on the remuneration for services performed outside the United States.

Income dealt with in Article 16 (Directors' Fees), Article 18 (Pensions, etc.) and Article 19 (Governmental Functions) is governed by the provisions of those Articles rather than by this Article.

Article 16. DIRECTORS' FEES

This Article provides that, when a company which is a resident of a Contracting State pays a fee to a resident of the other Contracting State for services rendered as a director of that company, the fee may be taxed in the first-mentioned State if it is treated in that State as a distribution of profits which may not be claimed as a deductible expense by the company. Remuneration and fees to an individual for services performed as a director which are a deductible expense to the company are covered under Article 14 (Independent Personal Services) or 15 (Dependent Personal Services), as appropriate. This Article is similar to the corresponding provision in the U.S.-Belgium income tax treaty.

Article 17. ARTISTES AND ATHLETES

This Article provides exceptions to the rules of Articles 14 (Independent Personal Services) and 15 (Dependent Personal Services) for remuneration derived by an entertainer (such as a theatre, motion picture, radio or television artiste or a musician) or an athlete. The remuneration of producers, directors, technicians, and others who are not entertainers or athletes is covered by Articles 14 and 15.

When an individual who is a resident of one of the Contracting States performs as an entertainer or athlete in the other Contracting State, the latter State may tax the remuneration for such services if the gross amount, including reimbursed expenses, exceeds $7,500 U.S. dollars. This is a compromise between Tunisia's preferred position, which is to tax such income at source with no threshold (as in the OECD and UN models), and the U.S. model, which allows a higher threshold.

Paragraph 2 provides that, where income for the performance of personal services by an entertainer or athlete does not accrue to that individual but is diverted to another person, the income may be taxed in the State where the services are performed, notwithstanding the provisions of Articles 7 (Business Profits), 14 (Independent Personal Services) and 15 (Dependent Personal Services). This is an anti-abuse rule, intended to have the same effect as the corresponding provision in the U.S. model.

Article 18. PENSIONS, ETC.

This Article concerns the taxation of pensions (other than for government service), social security benefits, annuities, alimony, and child support payments derived by a resident of a Contracting State.

Paragraphs 1a), 2 and 3 provide for exclusive taxation by the country of residence of pensions (other than a public pension for services performed in discharging governmental functions) annuities, and alimony. Notwithstanding this rule, the United States may tax such income derived by U.S. citizens who are residents of Tunisia in accordance with paragraph 2 of Article 22 (General Rules). The Article defines the terms "annuities" and "alimony", but leaves the definition of "pensions" to domestic law.

Paragraph 1b) provides that social security benefits paid by one Contracting State to a resident of the other Contracting State may be taxed by both States. The country of residence is obligated to avoid double taxation in accordance with Article 23. In the case of the United States, payments under the Railroad Retirement Act are treated as social security payments.

Under paragraph 4, child support payments are exempt from tax in both States. Under U.S. law, such payments are not taxable to the recipient (and are not deductible by the payor). Under Tunisian law such payments, like alimony, are taxable to the recipient (and deductible by the payor). Thus, a rule of taxation only by the residence country would lead to double taxation of child support payments made by a U.S. resident (not deductible by the payor for U.S. tax) to a Tunisian resident (taxable by Tunisia to the recipient). The Article avoids that result by providing that neither Contracting State will tax child support payments made to a resident of the other State. This rule does not require the United States to allow a deduction to the payor; the exemption provided applies to the recipient.

Article 19. GOVERNMENTAL FUNCTIONS

This Article concerns the taxation of remuneration and pensions paid to individuals out of public funds as compensation for services rendered in the discharge of governmental functions.

Paragraph 1 deals with remuneration other than pensions. Payments by a Contracting State or a political subdivision or local authority thereof to a citizen of that State for services rendered in discharging governmental functions may not be taxed in the other State. This rule also appears in the U.S. Model. Thus, for example, a U.S. citizen working at the U.S. Embassy in Tunis will be exempt from Tunisian tax on the compensation for those services. A citizen of Tunisia or of a third country similarly employed may be taxed by Tunisia in accordance with its domestic law and any other international obligations, such as the Vienna Convention on Diplomatic Relations; typically, such individuals will be host-country residents who are locally hired.

Paragraph 2 provides a different rule for pensions. Pensions paid out of public funds of a Contracting State or political subdivision or local authority thereof to an individual who is a resident of the other Contracting State for past services rendered in the discharge of governmental functions may be taxed only in the State of residence, unless the individual is a citizen of the paying State. This rule is a departure from that in the U.S. Model, and represents a concession to Tunisia's strong position that its residents deriving pensions (whether for private or public sector employment) should be taxed on the same basis without regard to where the pension originates. Thus, for example, a former U.S. Government employee who after retirement becomes a resident of Tunisia will be subject only to Tunisian income tax on his pension, unless the individual is a U.S. citizen. If he is a U.S. citizen, the United States may also tax, and Tunisia will provide relief from double taxation in accordance with Article 23.

Paragraph 3 makes it clear that remuneration or pensions paid by a Contracting State or a political subdivision or local authority thereof with respect to services rendered in connection with a trade or business carried on by either government or by a political subdivision or local authority thereof are not covered by this Article but by the applicable provisions of Articles 14 (Independent Personal Services), 15 (Dependent Personal Services), or 17 (Artistes and Athletes). This treatment is consistent with the U.S., OECD and U.N. Models, all of which exclude payments in respect of services rendered in connection with a business carried on by the governmental entity paying the compensation or pension. Each Contracting State applies the rules of its domestic law in determining whether services performed in its territory constitute governmental functions or are performed in connection with a trade or business.

An exception to the saving clause in paragraph 3b) of Article 22 (General Rules), preserves the benefit of this Article for a resident of a Contracting State who is not a citizen or immigrant of that State.

Thus, for example, the U.S. may not tax the salary of a Tunisian citizen who is a U.S. resident without immigrant status, if the amount is paid by the government of Tunisia for services in discharging governmental functions.

Article 20. STUDENTS AND TRAINEES

Paragraph 1 of this Article provides special tax rules for individual residents of one of the Contracting States who visit the other Contracting State for the purpose of full-time education or training. Education or training includes research, provided in each case that the individual participates in a full-time program consisting of study, research or training or any combination of such activities.

The host State agrees to exempt such individuals from tax on: a) remittances from abroad for their study or training, including amounts for living expenses during the period of study or training; b) an award received from a non-profit organization (in the case of a U.S. organization, one which qualifies under Code section 501(c)(3); and c) not more than $4,000 per year of remuneration for personal services. If the amount earned exceeds $4,000, the exemption applies to the first $4,000. The excess is taxable in accordance with domestic law, taking into account any personal exemptions and deductions allowable under domestic law.

The period of exemption for individuals who qualify under paragraph 1 may not exceed five years from the individual's date of arrival in the other State.

An exception to the saving clause contained in paragraph 3 b) of Article 22 (General Rules), preserves the benefit of this Article for a resident of a Contracting State who does not have the status of citizen or immigrant of that State. Thus, for example, the U.S. may not tax a student, apprentice or trainee who was a Tunisian resident immediately before arriving in the United States and who becomes a U.S. resident without immigrant status, if the amount paid to the individual is exempt under Article 20.

Article 21. OTHER INCOME

In general, any item of income derived by a resident of a Contracting State and not dealt with in one of the preceding articles is taxable only in the State of residence. An item of income is "dealt with" in an Article when items in the same category are addressed or defined in the Article, whether or not any treaty benefit is granted to that item of income. This Article deals both with types of income which are not dealt with elsewhere, such as, for example, lottery winnings, and also with types of income dealt with elsewhere in the Convention, but from sources in third States, and, therefore, not covered by the other Articles. The exclusive right of taxation accorded to the residence State under paragraph 1 applies whether or not the residence State exercises its right to tax the income covered by this Article.

The general rule extends to income from real property (as defined in paragraph 2 of Article 6 (Income From Real Property), for example, real property located in a third State, even if the real property is part of the business property of a permanent establishment or fixed base which the resident maintains in the other Contracting State. In such a case, the other State may not impose tax. However, other income derived from a right or property that is effectively connected with a permanent establishment or fixed base which the resident maintains in the other Contracting State may be taxed in that other State in accordance with Article 7 (Business Profits) or Article 14 (Independent Personal Services). Thus, in general, third-country income which is attributable to a permanent establishment maintained in the United States by a resident of Tunisia would be taxable by the United States. However, if a Tunisian resident derives income from real property located in a third State which is attributable to the resident's permanent establishment or fixed base in the United States, only Tunisia and not the United States may tax that income.

This Article is subject to the saving clause of paragraph 2 of Article 22 (General Rules) of the Convention. Thus, the United States may tax the income of a resident of Tunisia not dealt with elsewhere in the Convention, if that resident is a citizen of the United States.

Article 22. GENERAL RULES

This Article clarifies the relationship of the Convention to other international agreements and to domestic law.

Paragraph 1 provides that the Convention shall not be construed to deny tax benefits available under domestic tax laws or under the terms of any other agreement between the two States. The Convention is intended to benefit taxpayers and not to make them worse off than they would be in its absence. Thus, a taxpayer may always elect to rely on the rules of domestic law or of another agreement between the Contracting States. A taxpayer may not, however, make inconsistent choices between the rules of the Code and the rules of the Convention. For example, a taxpayer may not choose to apply the Convention's permanent establishment rules to one U.S. business operation and the Code trade or business rules to another to vary the treatment of profitable and loss operations, but it could apply the Code trade or business rules to all U.S. business operations and claim the reduced withholding rate under the Convention on U.S. dividends not effectively connected with a U.S. trade or business.

Paragraph 2 provides a "saving clause" which excepts the residents or citizens of a Contracting State from treaty benefits conferred by that State. Each State also preserves its right to tax certain former citizens under domestic law. Taxation based on citizenship is currently applicable only in the United States. The reference to former citizens preserves the taxing rules of Code section 877. Residence is defined under Article 4 (Fiscal Domicile) for all purposes of the Convention, including this provision. Thus, a U.S. resident alien, who under the Convention is determined to be a resident of Tunisia, is a resident of Tunisia for all purposes of the Convention, including the limitations of tax at source provided, for example, in Article 10 (Dividends). A U.S. citizen resident in Tunisia under the Convention generally remains subject to U.S. tax on his worldwide income in accordance with the rules of the Code.

Paragraph 3 provides certain exceptions to the saving clause of paragraph 2. Under paragraph 3 a), U.S. residents, as determined under Article 4 (Fiscal Domicile), and U.S. citizens are entitled to certain treaty benefits provided by the United States. Those benefits are the right to correlative adjustments of tax provided under paragraph 2 of Article 9 (Associated Enterprises), the rule stated in paragraph 1 of this Article, and the provisions of Article 23 (Relief from Double Taxation), 24 (Non-discrimination) and 25 (Mutual Agreement Procedure).

Under paragraph 3 b), individuals who are not U.S. citizens and are not permanent immigrants to the United States ("green card" holders) are entitled to the treaty benefits granted by the United States to individuals working for the Tunisian government under Article 19 (Governmental Functions), and to students and trainees under Article 20 (Students and Trainees), even if under domestic law they would otherwise be considered U.S. resident aliens. Since the introduction of Code section 7701(b) in 1984, it is much less likely that such a government employee or student would be treated as a U.S. resident under domestic law, but a trainee might be so considered.

Article 23. RELIEF FROM DOUBLE TAXATION

This Article specifies the method by which each of the Contracting States will avoid international double taxation of its residents, and in the case of the United States its citizens, with respect to income subject to tax in the other Contracting State.

Paragraph 1 provides that the United States will allow a credit for income taxes paid to Tunisia, as defined in paragraphs 2 b) and 3 of Article 2 (Taxes Covered), and an indirect (Code Section 902) credit with respect to Tunisian tax paid on profits distributed as dividends by a Tunisian corporation to a U.S. corporation holding 10 percent or more of its stock. The total credit is subject to the limitations of U.S. law, including the special limitation for purposes of the alternative minimum tax.

The limitation is determined by applying the source rules of the Internal Revenue Code.

Paragraph 2 provides that Tunisia will allow a credit for taxes paid to the United States, subject to the provisions of Tunisian law which limit the credit to the portion of pre-credit Tunisian tax attributable to the income which may be taxed in the United States. Although this Article permits Tunisia to tax U.S. source income, subject to a foreign tax credit, it does not prevent Tunisia from continuing to avoid double taxation by exempting such income from tax in certain cases.

For purposes of this Article, income is considered to arise in a Contracting State if it may be taxed in that State under the provisions of the Convention other than paragraph 2 of Article 22 (General Rules), which permits taxation on the basis of citizenship in accordance with domestic law. However, as noted above, it is understood that the limitation of the U.S. credit takes into account domestic law source rules applicable in determining such limitation.

The saving clause of paragraph 2 of Article 22 (General Rules) does not apply to this Article. Thus, the United States must grant the benefits of this Article to its citizens and residents, notwithstanding any less beneficial Code provisions.

Article 24. NON-DISCRIMINATION

Paragraph 1 prohibits either Contracting State from imposing other or more burdensome taxes or related requirements on residents who are nationals of the other Contracting State than on resident nationals of the first State in the same circumstances. Unlike the corresponding provision of the U.S. Model, this provision is limited to persons resident in a Contracting State, because Tunisia considers such an approach to be more consistent with the bilateral scope of the Convention. It does not imply on the part of either State an intent to discriminate on the basis of nationality among nonresidents who are otherwise in the same circumstances. (However, because the United States taxes its nonresident citizens on their worldwide income, U.S. nationals and Tunisian nationals resident outside the United States are not in the same circumstances.)

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.

Paragraph 3 ensures nondiscriminatory taxation by each Contracting State of permanent establishments of residents of the other Contracting State relative to the taxation of enterprises carried on by residents of that State. The branch taxes authorized by paragraph 7 of Article 10 (Dividends) are explicitly excepted from this provision.

It is understood, however, that the requirement of Code section 1446 that any partnership with income that is effectively connected with a U.S. trade or business withhold tax on amounts allocable to a foreign partner is not a form of discrimination within the meaning of paragraph 2 of this Article, notwithstanding the fact that the withholding obligation does not apply to amounts allocable to U.S. partners. No distinction is made between U.S. and Tunisian partnerships; the law requires in both cases that tax be withheld in respect of the partnership shares of non-U.S. partners. The requirement to withhold on the Tunisian but not the U.S. partner's share is, like other withholding on nonresidents aliens, a reasonable method for the collection of tax from persons who are not continually present in the United States. If tax has been overwithheld, the partner may file for a refund.

Paragraph 4 provides that, except where the payments are considered excessive in accordance with the provisions of paragraph 1 of Article 9 (Associated Enterprises), paragraph 7 of Article 11 (Interest), or paragraph 5 of Article 12 (Royalties), interest, royalties, and other disbursements made by a resident of a Contracting State to a resident of the other Contracting

State shall be allowed as a deduction in computing taxable income in the first State to the same extent as if the payment were made to a resident of that State.

Paragraph 5 prohibits discriminatory taxation of resident corporations based on their ownership; i.e. corporations owned by residents of the other Contracting State may not be subject to more burdensome taxes or connected requirements than corporations owned or controlled by residents of the taxing State which are engaged in the same activities.

Certain provisions of U.S. law relating to the taxation of gain on the liquidation of a subsidiary and to the taxation of small business (subchapter S) corporations distinguish between U.S.-owned and foreign-owned corporations, but are not considered discriminatory in the context of paragraph 5.

Under the Code, an 80% or more controlled corporation that distributes appreciated property to its parent corporation in complete liquidation of the subsidiary, is not taxed on the distribution as a general rule. However, tax is imposed on distributions to parent corporations that are tax-exempt organizations or, except to the extent provided in regulations, foreign corporations. Eligibility for tax-free treatment on liquidating distributions is not based on the nationality of the owners of the distributing corporation, but rather on whether such owners would be subject to corporate tax if they later sold or distributed the same property. The policy of the provision (section 367(e)(2)) is to collect the U.S. corporate tax on the liquidating distribution of appreciated property; the provision defers tax on such a distribution only if that tax can be collected on a subsequent sale or distribution. Similarly, the ineligibility of a corporation with nonresident alien shareholders to make the election to be an "S" corporation (taxed at the shareholder level) is not due to the nationality or residence of its shareholders, but to the fact that they are not subject to U.S. tax on a net basis as are U.S. shareholders. The purpose of the election, to permit individuals to carry on business in corporate form subject to the individual income tax rates, would not be achieved by extending the election to corporations owned by non-resident aliens. The provisions also exclude corporations with other types of shareholders, such as corporate shareholders, where the purpose of the provisions cannot be fulfilled or their mechanics implemented.

Paragraph 5 does not require granting the same relief for family circumstances to nonresident individuals as may be available to resident individuals.

The provisions of this Article apply not only to the income taxes specified in Article 2 (Taxes Covered), but to all taxes imposed at the national level or by a political subdivision or local authority.

The saving clause of paragraph 2 of Article 22 (General Rules) does not apply to this Article, by virtue of the exception in subparagraph 3 b) of Article 22. Thus, for example, a U.S. citizen who is resident in Tunisia may claim benefits in the United States under this Article.

Article 25. MUTUAL AGREEMENT PROCEDURE

This Article provides for cooperation between the competent authorities of the Contracting States, as defined in Article 3 (General Definitions), to resolve cases of double taxation.

Paragraph 1 provides that, if a resident of one of the Contracting States considers that the action of either or both States will result in taxation not in accordance with the Convention, he may present his case to the Contracting State of which he is a resident. If the case concerns a complaint of discrimination by the State of residence on the basis of citizenship, he may present the case to the State of which he is a citizen. In any case, a person requesting assistance from the competent authority may also avail himself of any remedies under domestic laws.

The competent authority to which the case is presented is to review the case and, if the claim is justified, seek a solution either independently or in conjunction with the competent authority of the other State. Any agreement reached by the competent authorities will be implemented without regard to any time or procedural limitations of domestic law. Thus, for example, the competent authorities will waive the domestic statute of limitations to make a refund under a competent authority agreement. However, no additional tax will be imposed if the statute of limitations has expired.

Paragraph 3 authorizes the competent authorities to seek a mutual agreement on any difficulty arising in applying the Convention and on cases of double taxation arising from situations not directly dealt with in the Convention. For example, the competent authorities may agree to a common definition of a term used in the Convention, to the characterization of a particular item of income, or to the appropriate allocation of deductions. They may also endeavor to coordinate the provisions of domestic law with respect to penalties and interest.

Paragraph 4 of the Convention is deleted by the Protocol and replaced by paragraphs 5, 6, and 7. Former paragraph 5 is renumbered 4. It simply confirms that the competent authorities may communicate directly, including meeting together, for the purpose of implementing this Article.

Paragraphs 5 and 6 provide rules to prevent "treaty shopping" by persons not intended to benefit from the provisions of the Convention. Paragraph 5 provides that a resident of a Contracting State, other than an individual, may not claim benefits under the Convention unless it meets any of three alternative tests. The first test has two parts: 1) more than 50 percent of the beneficial interest in such person, (or more than 50 percent of the number of shares of each class of shares in the case of a company) must be owned by any combination of individual U.S. residents and citizens, individual residents of Tunisia, and the Governments of the United States and Tunisia; and 2) the income of such person may not be used in substantial part, directly or indirectly, to meet liabilities to persons other than those identified above. The term "substantial" is not defined. Deductible payments which are less than 50 percent of the relevant income, however, will generally not be considered substantial, although in appropriate circumstances a lower percentage of income may be considered substantial. The term "income" in subparagraph (a)(ii) is to be interpreted as "gross income" under U.S. law, as determined without regard to the residence of the income recipient. Thus, in general, the term should be interpreted to mean gross receipts less cost of goods sold.

The purpose of the second condition is to prevent residents of third countries from setting up a company in a Contracting State which meets the ownership requirements but which passes on a large share of its income through deductible expenses, such as interest and royalties, paid to third country residents. This rule is not meant to deny benefits to companies which, for business reasons, purchase supplies from third countries. The focus is on liabilities for interest, royalties and certain compensation, not on the cost of goods sold. This intent is confirmed in subparagraphs b) and c), which authorize benefits to persons deriving income in connection with an active business in the country of residence and to companies that are publicly traded, respectively.

Subparagraphs b) and c) recognize that a company which is a resident of a Contracting State may be primarily owned by residents of third countries and/or may make substantial deductible payments to residents of third countries in the ordinary course of business. Subparagraph b) authorizes treaty benefits to persons that carry on an active business in the Contracting State of which they are residents and derive income from the other State in connection with that active business. Making or managing investments does not constitute an active business for this purpose unless it is a banking or insurance activity carried on by a bank or insurance company.

Companies whose principal class of shares is regularly traded in substantial volume on a recognized stock exchange are presumed to be owned by residents of the country in which it is so traded

and thus to qualify for treaty benefits under subparagraph c). The recognized exchanges for this purpose are defined. The competent authorities may agree on additional exchanges in future as appropriate. Although the Convention does not preclude agreement on an exchange in a third country, it is expected that any additional exchanges agreed upon would be in either the United States or Tunisia.

If any one of the three tests provided in paragraph 5 is satisfied, all items of income derived by the beneficial owners from the other Contracting State are entitled to treaty benefits. Claiming treaty benefits under paragraph 5 does not require advance competent authority ruling or approval. The tax authorities may, of course, on review, determine that the taxpayer has improperly interpreted the paragraph and is not entitled to the benefits claimed.

Paragraph 6 provides that in any case where treaty benefits are to be denied the competent authorities will consult. This does not imply an obligation that there be agreement, but the competent authority of the State denying benefits under paragraph 5 will first notify the other Contracting State of its decision and the reason for it.

Paragraph 7 provides authority to the competent authorities to grant treaty benefits to residents of the other Contracting State in certain cases even though such persons do not satisfy any of the preceding tests. This discretionary provision is not addressed to any particular situation, but is intended to allow some flexibility if a case should arise where the enumerated tests cause an unintended denial of benefits. The taxing State must decide when that is the case.

This Article is not subject to the saving clause of paragraph 2 of Article 22 (General Rules). Thus, for example, rules, definitions, procedures, etc., which are agreed upon by the competent authorities under this Article may be applied by the United States with respect to its citizens and residents even if they differ from the comparable Code provisions. Similarly, as indicated above, U.S. law may be overridden to provide refunds of tax to a U.S. citizen or resident under this Article.

Article 26. EXCHANGE OF INFORMATION

This Article provides that the competent authorities shall exchange information with respect to the taxes enumerated in Article 2 (Taxes Covered) for the purpose of applying the Convention or the domestic laws of the Contracting States concerning taxes covered by the Convention, provided that the taxation under the domestic laws is not contrary to the Convention. The information exchanged may relate to nonresidents as well as to residents of a Contracting State. The State receiving information under this Article must keep it secret in the same manner as information obtained under its domestic laws. The information may be made available only to persons involved in the assessment, collection, administration, or enforcement of the taxes covered by the Convention, or in the prosecution or determination of appeals in relation to such taxes; and the information may be used only for such purposes. It may be disclosed in public court proceedings or in judicial decisions. The General Accounting Office and the tax-writing committees of Congress may have access to the information exchanged, in their capacity of overseeing the administration of the U.S. income tax law, subject to the secrecy requirements applicable to domestic tax information.

Paragraph 2 provides that the obligation to exchange information under this Article does not require a Contracting State to carry out administrative measures contrary to the laws and practice of either State, or to supply information not obtainable in that or the other State under its laws or tax administration, or to supply information which would disclose any trade secret or which it is contrary to the public policy of that State to disclose. For example, if one of the States requests the other to furnish information which the first State could not obtain under its own laws and practice, the second State need not comply with that request even though its laws and practice permit it to collect such information with respect to domestic tax claims.

Paragraph 3 provides that, subject to the conditions of paragraphs 1 and 2, a Contracting State will obtain information requested by the other Contracting State in the same manner and to the same extent as if the tax in question were its own tax, even though it may have no tax interest in the particular case to which the request relates.

It is contemplated that the information exchanged under this Article may be on a routine basis, such as reporting on income payments made and tax withheld, or in response to specific requests. The competent authorities may agree on the items of information to be furnished routinely. They may also agree to furnish information spontaneously which they believe to be relevant in applying the Convention or the domestic laws covered by the Convention and to develop and implement other programs of information exchange within the conditions of this Article.

Article 27. DIPLOMATIC AGENTS AND CONSULAR OFFICERS

This Article confirms that this Convention does not affect any fiscal privileges afforded to diplomatic and consular officials under international law or other agreements.

Article 30. ENTRY INTO FORCE

The Convention is subject to ratification. It enters into force on the date of the exchange of instruments of ratification, which is to take place in Washington, D.C.. The withholding rate reductions provided for in Articles 10 (Dividends), 11 (Interest), and 12 (Royalties) take effect with respect to dividends, interest and royalties paid or credited on or after the first day of the fourth month after the Convention enters into force or on January 1 following the exchange of instruments of ratification, whichever comes earlier. With respect to other taxes, the Convention takes effect with respect to taxable years ending on or after December 31 of the year in which the Convention enters into force.

Article 31. TERMINATION

The Convention will remain in force indefinitely unless it is terminated by either Contracting State in accordance with this Article. Either State may terminate the Convention after it has been in force for 5 years by giving notice through diplomatic channels at least 6 months before the end of any calendar year. In that event, the Convention will cease to have force and effect for withholding taxes on dividends, interest and royalties paid or credited and for taxes on other income of taxable years beginning, on or after January 1 next following the expiration of the notice period of 6 months or more.

PROTOCOL

The Protocol sets forth agreements with respect to the interpretation of these points. Each has been mentioned in connection with the relevant article.

June 14, 1990