TREASURY DEPARTMENT
TECHNICAL EXPLANATION OF THE CONVENTION BETWEEN THE UNITED STATES OF AMERICA AND THE REPUBLIC OF AUSTRIA FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME SIGNED AT VIENNA ON MAY 31, 1996

INTRODUCTION

This document is a technical explanation of the Convention between the United States and Austria signed at Vienna on May 31, 1996 ("the Convention"). References are made to the Convention between the United States of America and the Republic of Austria for the Avoidance of Double Taxation with Respect to Taxes on Income, signed on October 25, 1956 ("the 1956 Convention"). The Convention replaces the 1956 Convention. Negotiations took into account the U.S. Treasury Department's current tax treaty policy, the Model Double Taxation Convention on Income and Capital, published by the organization for Economic Cooperation and Development ("the OECD Model"), and recent United States and Austrian treaties concluded with third countries.

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

The Convention is supplemented by a detailed Memorandum of Understanding. Although not part of the Convention, and not subject to ratification, as made clear in diplomatic notes exchanged at the time of signature of the Convention, the Memorandum of Understanding presents agreed understandings as to the proper interpretation of certain provisions of the Convention. The explanations of each article include explanations of any Memorandum of Understanding (MOU) provisions relating to that article.

The first section of the Memorandum of Understanding relates to a general matter of treaty interpretation. It states the agreement of the Contracting States that, with the exceptions

specified below, whenever a provision of the Convention corresponds to a provision of the OECD Model, the interpretations of that provision in the OECD Commentary should apply to the comparable provision in the Convention. The applicability of the Commentary to the convention is consistent with the Vienna Convention on the Law of Treaties of May 23, 1969.

The general rule stated above does not apply if either Contracting State has entered a reservation to the OECD Model or an observation to its Commentary with respect to the provision in question. It also does not apply if the Memorandum of Understanding to the Convention contains a contrary interpretation. Similarly, if a published interpretation by either Contracting State (such as this Technical Explanation), that has been provided to the competent authority of the other Contracting State prior to its publication, contains a contrary interpretation, or if at any time after the entry into force of the Convention, the competent authorities agree to a contrary interpretation, the above rule does not apply. This technical explanation has been provided to the competent authority of Austria. This technical explanation applies notwithstanding a different interpretation in the Commentary on the OECD Model, even where the interpretation in the OECD Model Commentary is adopted after the issuance of this technical explanation. The use of the OECD Commentary as provided in the Memorandum of Understanding can neither result in an amendment to the treaty as approved by the Senate and ratified, nor can it result in an interpretation contrary to the position of the United States. Such Commentaries can be helpful, as are interpretations by the competent authorities of both States, in providing explanations and interpretations of issues which arise during the life of the treaty.

Article 1. PERSONAL SCOPE

Article 1 provides that the Convention is applicable to residents of the United States or Austria, except where the Convention otherwise provides. Under Article 4 (Residence) 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 the person's domicile, citizenship, place of management or other similar criteria, subject to certain limitations, as described in Article 4. If, however, a person is, under those criteria, a resident of both Contracting States, Article 4 assigns a single state of residence.

This definition governs for all provisions of the Convention. Certain provisions are applicable to persons who may not be residents of either Contracting State. For example, Article 19 (Government Service) may apply to a citizen of a

Contracting State who is resident in neither State. Paragraph 1 of Article 23 (Nondiscrimination) applies to nationals (including citizens) of the Contracting States. Under Article 25 (Exchange of Information and Administrative Assistance), information may be exchanged with respect to residents of third states. Residents of a Contracting State are not automatically entitled to benefits under the Convention; they must also satisfy one of the requirements of Article 16 (Limitation on Benefits) establishing the right to obtain treaty benefits.

Paragraph 2 makes explicit, on a reciprocal basis, the generally accepted principle that no provision in the Convention may restrict any exclusion, exemption, deduction, credit or other allowance now or hereafter accorded by the laws of the Contracting States or by any other agreement between the Contracting States. Thus, for example, subparagraph 2(a) provides that if a deduction would be allowed under the U.S. Internal Revenue Code (the "Code") in computing the taxable income of a resident of Austria, the deduction will remain available to that person in computing taxable income under the treaty. In no event may the treaty increase the tax burden on residents of the Contracting States. Thus, a right to tax given by the treaty cannot be exercised by the United States unless that right also exists under the Code.

A taxpayer may always rely on the Code treatment. This does not mean, however, that a taxpayer may pick and choose among Code and treaty provisions in an inconsistent manner in order to minimize tax. For example, assume a resident of Austria has three separate businesses in the United States. One is a profitable permanent establishment. The other two are trades or businesses, which would earn taxable income under the Code, but which do not meet the permanent establishment threshold tests of the Convention, one of which is profitable and the other which 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. The loss would offset the profits of the two profitable ventures. The taxpayer may not invoke the Convention to exclude the profits of the profitable trade or business and invoke the Code to claim the loss of the unprofitable trade or business against the profit of the permanent establishment. (See Rev. Rul. 84-17 1984-1 C.B. 308) However, if the taxpayer invokes the Code for the taxation of all three ventures, he would not be precluded from invoking the Convention with respect, for example, to any dividend income that is not effectively connected with any of his business activities in the United States.

Subject to the provisions of paragraph 3, subparagraph 2(b) establishes that nothing in the Convention can be used to deny any benefit granted by any other agreement between the United

States and Austria, regardless of any provisions to the contrary, or silence, in this convention.

Paragraph 3 modifies the rule of subparagraph 2(b) with respect to certain obligations undertaken by the Contracting States under other agreements. Subparagraph 3(a) provides that, notwithstanding any other agreement to which the Contracting States may be parties, a dispute concerning whether a measure falls within the scope of this Convention shall be considered only by the competent authorities of the Contracting States as defined under subparagraph 1(e) of Article 3 (General Definitions), and the procedures under this Convention exclusively shall apply to the dispute. Thus, dispute resolution procedures provided in trade, investment, or other agreements between the Contracting States (including multilateral agreements to which both Contracting States are parties) shall not apply for the purpose of determining the scope of this Convention.

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

For purposes of paragraph 3, subparagraph 3(c) defines a "measure" as a law, regulation, rule, procedure, decision, administrative action, or any other form of measure.

Paragraph 4 contains the traditional saving clause while paragraph 5 provides exceptions to the saving clause. Under paragraph 4, each Contracting State reserves its right, except as provided in paragraph 5, to tax its residents (as determined under Article 4) and citizens as if the Convention had not come into effect and notwithstanding any Convention provisions to the contrary. If, for example, an Austrian 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 Austrian 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 the normal Code rules. (For special

foreign tax credit rules applicable to the U.S. taxation of certain U.S. income of its citizens resident in Austria see paragraph 2 of Article 22 (Relief from Double Taxation)).

"Residence" for the purpose of the saving clause is determined under Article 4. Thus, for example, if an individual who is not a U.S. citizen is a resident of the United States under the Code and is also a resident of Austria under Austrian law, and that individual has a permanent home available to him in Austria and not in the United States, he would be treated as a resident of Austria under Article 4 and for purposes of the saving clause. The United States would not be permitted to apply its statutory rules to that person if they are inconsistent with the treaty.

Under paragraph 4 the Contracting States also reserve their right to tax former citizens whose loss of citizenship had as one of its principal purposes the avoidance of tax, but only for a period of 10 years after the loss of citizenship. Such former citizen of the United States is taxable in accordance with the provisions of section 877 of the Code.

Paragraph 5 sets forth exceptions to the saving clause in cases where its application would contravene policies reflected in the Convention that are intended to benefit a Contracting State's citizens and residents. Subparagraph a) lists certain provisions that will apply to all of the citizens and residents of a Contracting State despite the general saving clause rule of paragraph 4: (1) Paragraph 2 of Article 9 (Associated Enterprises) grants the right to a correlative adjustment, and, in particular, permits the override of the statute of limitations for the purpose of refunding tax under such a correlative adjustment. (2) Paragraph 4 of Article 13 (Capital Gains) seeks to blend the laws of the two Contracting States with respect to the taxation of gains from the alienation of assets removed from a permanent establishment or fixed base. In doing so it modifies, to some extent, the tax that the residence country may impose on such gains. (3) Paragraphs 1(b) and 3 of Article 18 (Pensions) deal with social security benefits and alimony. Their inclusion in the exceptions to the saving clause means that such payments will be exempt from tax in the country of residence of the recipient, notwithstanding a statutory right of the residence country to tax the recipient on the income. (4) Article 22 (Relief from Double Taxation) confers the benefits of U.S. double taxation relief on U.S. citizens and residents, and Austrian benefits on its residents. To apply the saving clause to this Article would render the Article meaningless. (5) Article 23 (Nondiscrimination) prohibits discriminatory taxation by one Contracting State of the nationals and residents of the other Contracting State. These prohibitions are intended to apply even if the national or resident of the other State is also a national

or resident of the taxing State. (6) Article 24 (Mutual Agreement Procedure) may confer U.S. benefits on U.S. citizens and residents and Austrian benefits on its residents. The statute of limitations may be waived for refunds and the competent authorities are permitted to use a definition of a term that differs from the statutory definition in one or both countries. As with the foreign tax credit, these benefits are intended to be granted by a Contracting State to its citizens and residents.

Subparagraph 5(b) provides a different set of exceptions to the saving clause. As applied to the United States, these exceptions are available only to individuals who are neither U.S. citizens nor lawful permanent residents (i.e., "green card" holders) but who remain in the Unites States long enough to become residents under the Code. As applied to Austria, these exceptions are available to individuals who are not citizens of Austria. The benefits preserved by this paragraph are the host country exemptions for the following items of income: Government service salaries and pensions under Article 19 (Government Service); certain income of visiting students and trainees under Article 20 (Students and Trainees); and the income of diplomatic and consular officers under Article 26 (Diplomatic Agents and Consular Officers).

Article 2. TAXES COVERED

This Article identifies the U.S. and Austrian taxes to which the Convention applies. Paragraph 1 makes the general statement that the Convention applies to taxes on income imposed on behalf of a Contracting State. Thus, except, as noted below, the Convention does not apply to state and local taxes or to capital taxes.

Paragraph 2 identifies the existing covered taxes. Subparagraph (a) identifies the U.S. taxes covered as the Federal income taxes imposed by the Code. The Convention does not apply to social security taxes (Code sections 1401, 3101 and 3111). U.S. and Austrian social security taxes are dealt with in the bilateral Social Security Totalization Agreement, which entered into force on November 1, 1991.

Subparagraph 2(b) identifies the Austrian taxes covered as the Einkommensteuer (income tax), and the Koerperschaftsteuer (corporation tax). The 1956 Convention also covers these taxes.

Paragraph 3 states that the Convention will apply to any taxes that are identical, or substantially similar, to those enumerated in paragraph 2, and which are imposed in addition to, or in place of, the existing taxes after the date of signature of

the Convention. The paragraph also provides that the U.S. and Austrian competent authorities shall notify each other of any changes in their taxation laws that are significant to the operation of the Convention. They are also to notify each other of any official published materials concerning the application of the Convention. Such materials include explanations, regulations, rulings or judicial decisions.

Paragraph 4 expands the type of taxes covered for certain specific purposes. With respect to Article 23 (Non-Discrimination), the Convention applies in both Contracting States to all taxes imposed by a Contracting State or a political subdivision or local authority thereof. Thus, although state and local taxes in the United States are not, for any other purpose, covered by the Convention, they must be imposed in a non-discriminatory manner, consistent with the rules of Article 23. The 1956 Convention applies the same scope of taxes covered for nondiscrimination purposes. Paragraph 4 also provides that for purposes of applying paragraphs 1 through 5 of Article 25 (Exchange of Information and Administrative Assistance), the Convention applies to all taxes imposed by the Contracting States. Thus, for example, the United States can request information from Austria for the purpose of enforcing the Federal estate tax or Federal excise taxes. Information cannot be requested, however, for state and local tax purposes.

Article 3. GENERAL DEFINITIONS

Article 3 defines terms used in the Convention. Paragraph 1 defines a number of basic terms used in the Convention. Paragraph 2 addresses terms that are not defined in the Convention. Other articles define certain other terms. 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, 11, and 12, respectively, which deal with the taxation of those items of income.

Subparagraph 1(a) defines the term "person" to include an individual, an estate, a trust, a company and any other body or persons.

Subparagraph 1(b) defines the term "company" as a body corporate or an entity treated as a body corporate for tax purposes. Subparagraph 1(c) defines the terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" as an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State, respectively. Since the terms "body corpo-

rate" and "enterprise" are not defined in the Convention, in accordance with paragraph 2 of this Article, they have the meaning that they have under the laws of the Contracting State whose tax is being applied.

Subparagraph 1(d) defines the term "international traffic" as any transport by a ship or aircraft, except when such transport is solely between places in the other Contracting State. The meaning of the term "other Contracting State" becomes clear in the context of Article 8 (Shipping and Air Transport), which refers to the profits of an enterprise of a Contracting State related to activities carried on in international traffic. The reference to the "other Contracting State," therefore, refers to the State other than the one in which the enterprise is resident. The exclusion from international traffic of transport solely between places within the other Contracting State means, for example, that a carriage of goods or passengers solely between New York and Chicago by an Austrian carrier (if that were possible under U.S. law) would not be treated as international traffic. The substantive taxing rules of the Convention relating to the taxation of income from transport, principally Article 8, therefore, would not apply to income from such carriage, and the United States would not be required to exempt the income under Article 8. 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 then only on a net basis. If, however, goods or passengers are carried by an Austrian carrier from Vienna to New York, with some of the goods or passengers carried only to New York, and the rest taken to Chicago, the entire transport would be international traffic.

Subparagraphs 1(e)(i) and 1(e)(ii) define the term "competent authority" for the United States and Austria, respectively. The U.S. competent authority is the Secretary of the Treasury or his delegate. The Secretary of the Treasury has delegated the competent authority function to the Commissioner of Internal Revenue, who has, in turn, re-delegated the authority to the Assistant Commissioner (International). With respect to interpretative issues, the Assistant Commissioner acts with the concurrence of the Associate Chief Counsel (International) of the Internal Revenue Service. In Austria the competent authority is the Minister of Finance or his delegate. The routine relief from source taxation on dividends in Austria is carried out by the Regional Directorate for Vienna.

The terms "United States" and "Austria" are defined in subparagraphs 1(f) and 1(g), respectively. The term "United States" is defined 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 geographically, the term

includes the states of the United States and the District of Columbia. The Convention also explicitly includes the U.S. continental shelf within the definition of the United States to the extent that; under international law, the United States has sovereign right to explore for and exploit the natural resources of the continental shelf and the waters above it. The term "Austria" is defined to mean the Republic of Austria.

Subparagraph 1(h) defines the term "nationals" of a Contracting State. A national is an individual possessing the nationality of a Contracting State (i.e., a citizen), and any legal person, partnership or association deriving its status, as such, from the laws in force in a Contracting State.

Paragraph 2 provides that, in applying the Convention, any term used but not defined in the Convention, unless the context otherwise requires, will have the meaning it has under the laws of the Contracting State concerning the taxes to which the Convention applies. Under the U.S. and Austrian interpretation of this provision, any meaning under the applicable tax laws of that State prevails over a meaning given to the term under other laws of that State. If, however, the meaning of a term cannot be readily determined under the laws of a Contracting State, or if there is a conflict in meaning under the laws of the two States that creates problems in the application of the Convention, the competent authorities may, pursuant to the provisions of paragraph 3(e) of Article 24 (Mutual Agreement Procedure), establish a common meaning in order to prevent double taxation or to further any other purpose of the Convention. This common meaning need not conform to the meaning of the term under the laws of either Contracting State.

It is understood that, when reference is made in paragraph 2 in the internal law of a Contracting State for purposes of defining a term, it means the law as in effect at the time the treaty is being applied, not the law as in effect at the time the treaty was signed. This use of "ambulatory definitions" is generally accepted within the OECD. The use of an ambulatory definition, however, may lead to results that are at variance with the intentions of the negotiators and of the Contracting States when ratifying the treaty. The reference in paragraph 2 to "unless the context otherwise requires" a definition different from the internal law definition of the Contracting State whose tax is being imposed refers to a circumstance where the result intended by the negotiators or by the Contracting States is different from the result that would obtain under the statutory definition.

The first section of the Memorandum of Understanding, described in the introductory section of this Technical Explanation, is relevant for the application of paragraph 2 of

this article. It provides that, with certain exceptions, interpretations found in the Commentary to the OECD Model will be relevant for understanding the meaning of terms in this Convention, when those terms are also used in the OECD Model.

Article 4. RESIDENT

Article 4 sets forth rules for determining whether a person is a resident of a Contracting State for purposes of the Convention. The treaty definition of residence is to be used only for purposes of the Convention. The 1956 Convention does not contain a comprehensive definition of residence.

Determination of residence is important because, as noted in the explanation to Article 1 (General Scope), as a general matter only residents of the Contracting States may claim the benefits of the Convention. Any entitlement to benefits of a resident of a Contracting State is, however, subject to the requirements of Article 16 (Limitation on Benefits).

The determination of residence for treaty purposes looks to a person's liability to tax under the laws of the Contracting States. A person who, under those laws, is a resident of one Contracting State and not of the other need look no further. Except as specifically provided in the Article (e.g., subparagraph 1(c)) for purposes of the Convention that person will be treated as a resident of the State in which he is resident under internal law. If, however, a person is resident in both Contracting States under their respective taxation laws, the tie-breaker rules attempt to assign one State of residence to such a person.

Paragraph 1 defines a "resident of a Contracting State." In general, this definition incorporates the definitions of residence in U.S. and Austrian law, by defining a resident as a person who, under the laws of a Contracting State, is subject to tax there by reason of his domicile, residence, citizenship, place of management, place of incorporation, or any other similar criterion. Thus, as a general matter, residents of the United States include U.S. citizens as well as aliens who are considered U.S. residents under U.S. law.

Paragraph 1 provides certain exceptions to this general rule. Under subparagraph 1(a), if a person is liable to tax only in respect of income from sources within a State, the person will not be treated as a resident of that Contracting State for purposes of the Convention. Thus, for example, an Austrian consular official in the United States, who may be subject to U.S. tax on U.S. source investment income, but who is not taxable in the United States on non-U.S. income, would not be considered a resident of the United States for purposes of the Convention

(See Code section 7701(b)(5)(B)). Similarly, an Austrian enterprise with a permanent establishment in the United States is not, by virtue of that permanent establishment, a resident of the United States. The enterprise is subject to U.S. tax only with respect to its income that is attributable to the U.S. permanent establishment, not with respect to its worldwide income.

Subparagraph 1(b) provides that the income of a partnership, estate or trust will be treated as the income of a resident of a Contracting State only to the extent that the income derived or paid by such person is subject to tax in that State as the income of a resident, either in the hands of the person deriving the income or in the hands of its partners, beneficiaries or grantor. The Memorandum of Understanding describes the treatment of pass-through entities, such as limited liability companies, not explicitly referred to in the Article.

Under U.S. law, any organization classified as a partnership for tax purposes is taxable on a transparent basis. (Certain publicly-traded partnerships, however, will be classified for tax purposes as corporations taxable at the entity level.) Thus, under paragraph 1(b) of Article 4, Austrian source income received by an entity classified as a partnership for U.S. tax purposes will generally be treated as income of a U.S. resident to the extent the income is included in the distributive share of partners or members that are themselves U.S. residents (looking through any partnerships that are themselves partners or members and applying the provisions of Article 16 (Limitation on Benefits).

Certain limited liability companies are classified as partnerships for U.S. tax purposes. Under the Memorandum of Understanding, the residence of entities treated as pass-throughs for tax purposes is determined on the same basis as for a partnership. Similarly, the treatment under the Convention of income received by a 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 circumstances.

Subparagraph 1(c) specifies additional conditions for determining whether a U.S. citizen or an alien lawfully admitted for permanent residence in the United States (i.e., a "green card" holder) will be treated as a U.S. resident for purposes of the Convention. If such an individual is not also a resident of Austria under paragraph 1, he will be treated as a resident of the United States only if he has a substantial presence, permanent home or habitual abode in the United States. Substantial presence for this purpose is a similar concept to "substantial presence" under section 7701(b) of the U.S. Internal Revenue code and the regulations thereunder (a minimum physical presence of

more than 30 days in the calendar year for which the determination is relevant and a total of at least 183 days in the current and previous two calendar years). Thus, for example, an individual resident of Mexico who is a U.S. citizen by birth, or who is a Mexican citizen and holds a U.S. green card, but who, in either case, does not live in the United States, would not be entitled to benefits under the treaty. On the other hand, a U.S. citizen who is transferred to Mexico for two years but who maintains a permanent home or habitual abode in the United States would be entitled to treaty benefits. However, the residence of a U.S. citizen or green card holder who is also a resident of Austria under Austrian law will be determined by application of the tie-breaker rules of paragraph 2.

Subparagraph 1(d) clarifies that a Contracting State, and its political subdivisions or local authorities, or agencies or instrumentalities of such governments, subdivisions, etc., will be treated as residents of that State. Thus, such governmental entities are entitled to treaty benefits as residents of a Contracting State.

Although the Article does not deal explicitly with the residence of a tax-exempt organization, including pension funds, it is understood that such an organization that is established under the laws of a Contracting State, and is, therefore, a resident of that State under its law, is to be treated as a resident of that State for purposes of the Convention as well. The United States and Austrian negotiators agreed that such an organization is "liable to the tax laws" of its State of residence, under which it pays zero tax if it complies with certain standards, and that if it does not comply with these standards it will pay tax on its income. Thus, the United States and Austria agree that the fact that a charitable organization or pension fund is exempt from tax in its resident country is not to be construed to deny such organization or fund resident status under the Convention. Paragraph 1(g) of Article 16 also affects the treatment of such entities for purposes of the Convention.

Paragraph 2 provides a series of tie-breaker rules to determine a single State of residence for an individual who, under paragraph 1, would be a resident of both countries. The first test is where the individual has a permanent home. If that test is inconclusive because the individual has a permanent home available in both States or in neither State, his residence is in the Contracting State where his personal and economic relations are closest, i.e., his "center of vital interests". The Memorandum of Understanding clarifies that a period of time beyond a year may have to be examined to identify the center of vital interests.

If the center of vital interests test is also inconclusive,

residence is in the Contracting State where the individual 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 nationality. If he is a national of both States or of neither of them, the competent authorities shall endeavor to assign a single State of residence by mutual agreement.

Paragraph 3 resolves dual-residence issues for corporations. Under U.S. law, a corporation 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. Under Austrian law a corporation is treated as a resident of Austria if it is registered or managed and controlled there. Dual residence, therefore, can arise if a corporation organized in the U.S. is managed and controlled in Austria. Under paragraph 3, a dual-resident corporation will be treated as a resident of a Contracting State if it is created under the laws of that State, or political subdivision thereof. This provision conforms to U.S. law.

Paragraph 4 deals with persons other than individuals or companies that are resident in both the United States and Austria under paragraph 1. The competent authorities are instructed to determine by mutual agreement a single State of residence for that person for purposes of the Convention and to determine the mode of application of the Convention to such person.

Article 5. PERMANENT ESTABLISHMENT

This Article defines the term "permanent establishment," which is significant for several articles of the Convention. The existence of a permanent establishment in a Contracting State is necessary under Article 7 (Business Profits) for taxation by that State of the business profits of a resident of the other Contracting State. Since the term "fixed base" in Article 14 (Independent Personal Services) is understood by reference to the definition of "permanent establishment," this Article is also relevant for purposes of Article 14. Articles 10, 11, and 12 (dealing with dividends, interest, and royalties, respectively) provide for reduced rates of tax at source on payments of these items of income to a resident of the other State only when the income is not attributable to a permanent establishment or fixed base that the recipient has in the source State. The concept is also relevant in determining which Contracting State may tax certain gains under Article 13 (Capital Gains) and certain "other income" under Article 21 (Other Income).

This Article follows closely recent U.S. treaties and the OECD Model provisions. It is similar to the definition of a permanent establishment in the 1956 Convention except that the

exceptions from the definition of "permanent establishment" have been broadened to include not only certain specified activities but also any other activity of a preparatory or auxiliary character. Like other recent U.S. income tax conventions, it adds a rule that treats drilling rigs or ships in the same manner as construction sites.

Paragraph 1 provides the basic definition of the term "permanent establishment." The term means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

Paragraph 2 lists examples of fixed places of business that constitute a permanent establishment. The list is illustrative and non-exclusive and includes a place of management, a branch, an office, a factory, a workshop, and a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources.

Paragraph 3 provides rules to determine when a building site a construction, assembly or installation project, or an installation or drilling rig or ship used to explore or develop natural resources constitutes a permanent establishment. The site, project, etc., constitutes a permanent establishment only if it lasts for more than 12 months. The twelve-month test applies separately to each individual site or project and the period begins when work (including preparatory work carried on by the enterprise) 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 purposes of applying the twelve-month threshold test. For example, the construction of a housing development would be considered as a single project even if each house is constructed for a different purchaser. If the twelve-month threshold is exceeded, the site or project constitutes a permanent establishment from its first day. This interpretation is based on the Commentaries to paragraph 3 of Article 5 (Permanent Establishment) of the OECD Model, which contains language almost identical to that in this Convention with respect to construction activities, and, therefore, conforms to the generally accepted international interpretation of the language in paragraph 3 of Article 5 of the Convention with respect to such activities. Paragraph 3 applies the same twelve-month threshold test to drilling rigs, both onshore and offshore. Rigs must, therefore, be present in a Contracting State for twelve months to constitute a permanent establishment.

Paragraph 4 contains exceptions to the general rule of paragraph 1 that a fixed place of business through which a business is carried on constitutes a permanent establishment. The paragraph 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. The use of facilities solely to store, display or deliver merchandise belonging to an enterprise will not constitute a permanent establishment of that enterprise. The maintenance of a stock of goods belonging to an enterprise solely for the purpose of storage, 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. The maintenance of a fixed place of business solely for activities that have a preparatory or auxiliary character for the enterprise, such as advertising or the supply of information (but not including the carrying on of scientific research), will not constitute a permanent establishment of the enterprise. It is understood that a combination of these activities 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 acting on behalf of an enterprise will be 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. The contracts referred to are those relating to the essential business operations of the enterprise; not those relating to ancillary activities. If, however, the agent's 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 will not be a permanent establishment of the enterprise.

Paragraph 6 provides that an enterprise will not be 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.

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 or not a permanent establishment exists will be made solely on the basis of the factors described in paragraphs 1 through 6 of the Article and not on the ownership or control relationship between the companies.

Article 6. INCOME FROM REAL PROPERTY

Paragraph 1 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 in which

the property is situated. Like the OECD Model, the paragraph specifies that income from real property includes income from agriculture or forestry. This Article does not grant an exclusive taxing right to the situs State, but assigns it the primary taxing right. The Article does not impose any limitation in terms of rate or form of tax on the situs State, although, as discussed below in connection with paragraph 5, it does allow the taxpayer the right to elect to be taxed on a net basis.

Paragraph 2 defines the term "real property" as having the meaning that it has under the laws of the situs country. In addition, the paragraph specifies certain classes of property which, regardless of internal law definitions, are to be included within the meaning of the term for purposes of the Convention. The definition conforms to that in the OECD Model.

Paragraph 3 elaborates on the general rule of paragraph 1 by specifying that the income referred to in paragraph 1 means income from any use of real property, including, but not limited to, income from direct use by the owner and rental income from the letting or sub-letting of real property.

The Memorandum of Understanding further elaborates on paragraph 3. It clarifies that Article 6 applies not only to income earned through the use of real property owned by the income recipient, but also to income from the exploitation of rights in real property. For example, consider a piece of real property in Austria owned by a resident of Germany and leased by the German owner to a U.S. corporation, which then sub-leases the property. It is understood that the rules of Article 6 will apply to the income earned by the U.S. corporation from its sublease of the property, even though the U.S. corporation does not own the Austrian real property, and the property that it does own (i.e., the rights in the property) is technically movable property.

Paragraph 4 specifies that the basic rule of paragraph 1 (as elaborated in paragraph 3) applies to income from real property of an enterprise and to income from real property used for the performance of independent personal services. This provision clarifies that the situs State may tax the real property income of a resident of the other Contracting State in the absence of a permanent establishment or fixed base in the situs State, notwithstanding the requirements of Articles 7 (Business Profits) and 14 (Independent Personal Services) that to be taxable, income must be attributable to a permanent establishment or fixed base, respectively.

Paragraph 5 permits a taxpayer to elect to be taxed on real property income on a net basis, that is, as if such income were attributable to a permanent establishment. The election is

binding for the taxable year of the election and all subsequent taxable years unless the competent authorities, upon request of the taxpayer, agree to terminate the election. In the United States, revocation will be granted in accordance with the provisions of the relevant regulations under section 897.

Article 7. BUSINESS PROFITS

This Article provides rules for taxation by a Contracting State of the business profits of an enterprise of the other Contracting State. It updates the corresponding Article in the 1956 Convention to conform more closely to current U.S. treaty policy and to the OECD Model.

The general rule, found in paragraph 1, is that business profits of an enterprise of one Contracting State may be taxed by the other Contracting State only if the enterprise carries 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 only so much of the income of the enterprise that is attributable to the permanent establishment. This rule differs from the comparable rule in the 1956 Convention, which contained a limited force of attraction rule that permitted the State in which the permanent establishment is located to tax income of the enterprise even if not attributable to the permanent establishment, but only to the extent that the income is derived from sources in that State.

Paragraph 2 provides rules for attributing business profits to a permanent establishment. The Contracting States will attribute to a permanent establishment the profits that it would have been expected to earn had it been a distinct and independent entity engaged in the same or similar activities under the same or similar circumstances. The computation of the business profits attributable to a permanent establishment under this paragraph is subject to the rules of paragraph 3 regarding deductions for expenses incurred for the purposes of earning the income.

The profits attributable to a permanent establishment may be from sources within or without a Contracting State. Thus, for example, items of foreign source income described in section 864(c)(4)(B) of the Code may be attributed to a U.S. permanent establishment of an Austrian enterprise and subject to tax in the United States. The concept of "attributable to" in the Convention is analogous to but narrower than the concept of "effectively connected with" in section 864(c) of the Code. Thus, the limited "force of attraction" rule of 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 a reasonable allocation of expenses incurred for the purposes of the permanent establishment, regardless of where the expenses are incurred. This rule ensures that business profits will be taxed on a net basis. Among the expenses that may be incurred for the purposes of the permanent establishment are expenses for research and development, interest and other similar expenses, as well as executive and general administrative expenses. The paragraph specifies that the allocation of the enumerated expenses made in determining the profits attributable to the permanent establishment must be "reasonable." This language allows the United States to apply the types of expense allocations found in U.S. law, for example, in Treasury Regulations sections 1.861-8 and 1.882-5.

This rule is not limited to expenses incurred exclusively for the purposes of the permanent establishment, but includes expenses incurred for the purposes of the enterprise as a whole, or that part of the enterprise that includes the permanent establishment. Deductions are to be allowed regardless of which accounting unit of the enterprise books the expenses, so long as they are incurred for the purposes of the permanent establishment. Thus, a portion of the interest expense recorded on the books of the home office in one State may be deducted by a permanent establishment in the other (or vice versa) if properly allocable thereto.

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 with respect to its purchasing activities. If the sole activity were the purchasing of goods or merchandise for the enterprise, the issue of the attribution of income would not arise, because, under subparagraph 4(d) of Article 5 (Permanent Establishment), there would be no permanent establishment.

Paragraph 5 states that, to assure continuous and consistent tax treatment, the same method for determining the profits of a permanent establishment is to be used from year to year, unless there is good and sufficient reason to change. In conformity with current U.S. treaty policy and the OECD Model, the paragraph applies "for the purposes of the preceding paragraphs."

Paragraph 6 explains the relationship between the provisions of this Article and other provisions of the Convention. 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 this Article. Thus, for example, the taxation of interest generally will be determined by the rules of Article 11 (Interest), and not by Article 7. However, as provided in paragraph 3 of Article 11, if the interest is attributable to a permanent establishment, the provisions of Article 7 apply instead.

Under this paragraph, income derived from shipping and air transport activities that are described in Article 8 (Shipping and Air Transport) is taxable only in the country of residence of the enterprise regardless of whether it is attributable to a permanent establishment situated in the source State. For example, an airline ticket office situated in the United States' that constitutes a permanent establishment of an airline of Austria will not be subject to tax in the United States with respect to the profits attributable to that office, because such income is encompassed by Article 8.

Paragraph 7 specifies that the term "business profits" as used in the Convention includes income from the rental of tangible personal property. Some countries subject this class of income to gross basis taxation at source. The inclusion of this class of income in business profits means that such income earned by a resident of a Contracting State can be taxed by the other Contracting State only if the income is attributable to a permanent establishment maintained by the resident in that other State, and, if the income is taxable, it can be taxed only on a net basis.

Paragraph 8 contains a special rule relating to a particular type of business entity, a sleeping partnership (Stille Gesellschaft) under Austrian law. A sleeping partnership is not a commercial partnership in the usual sense. It is a contract concluded under commercial law by which an investor (the sleeping partner) contributes money or money's worth to the business of his contracting partner in exchange for a share in the profits of the business and under the entitlement to obtain specified information about the development of the business. Commercial law provides only one type of contract (with the possibility of arranging bilaterally various details in different ways, e.g., the exclusion of participation in the losses, as long as the essential matters prescribed by law are observed). In relation to third parties (e.g., customers, suppliers and other contractors of the enterprise) only the owner of the business is liable for the debts of the enterprise. Internally, it depends on the terms of the contract with the sleeping partner as to

whether the sleeping partner participates only in profits or has also to bear a portion of the losses; but, even in the latter case, he is by law not obligated to increase his investment.

Under Austrian tax law, there are two kinds of sleeping partnerships, the typical form and the non-typical form. In a typical sleeping partnership, a partner whose interest is not disclosed (a "sleeping partner") participates in (i) either the profits and losses of the business, or (ii) only in its profits, or (iii) in its profits up to a certain amount (and not in the losses). However, in a typical sleeping partnership, a sleeping partner does not participate in the capital and assets of the business, and his rights upon withdrawal from the partnership are limited to the return of his investment. Under Austrian tax law, the profit of the sleeping partner in a typical sleeping partnership is within the category of income from investment activities.

In a non-typical sleeping partnership, a sleeping partner is entitled to participate in the increase in net wealth of the business property (that is, a certain portion of the business value in case of termination of the contract) as well as in the profits and losses of the business. The economic position of a sleeping partner in a non-typical sleeping partnership is rather close to that of a partner in a partnership; thus, the sleeping partnership contract is subjected to the Austrian partnership taxation regime and the profit is considered to be income from commercial activities.

The taxation of the income of a sleeping partnership (both the typical and the non-typical forms) under Austrian law is illustrated by the following example. The U.S. corporation (US) invests 10,000 under a sleeping partnership contract in the Austrian company (A). US is granted a 10% share in the profits of A. In year 1 A makes a profit (before taxes and before deduction of the sleeping partner's share) of 20,000. In year 2, after the finalization of the financial statements for year 1, US receives a cash payment of 2,000.

Under Austrian domestic law, Austria's taxation of the typical sleeping partnership is as follows: In year 2, A must withhold 25% of 2,000 (which is 500). In year 3, US must file a corporation tax return in Austria for year 1. Assume that the net income of US from its Austrian investment (e.g. after deduction of refinancing cost, travel expenditure, etc.) is 1,000. US will receive an assessment notice (probably also in year 3) according to which the tax liability for year 2 is determined to be 340. The 500 previously withheld is credited against that tax liability so that, at the end, US has a claim for refund of 160 against the Austrian government. The taxable income of A is 18,000 (in year 1) because A's income is reduced

by the 2,000 distributed to US.

Under Austrian domestic law, Austria's taxation of the non-typical sleeping partnership is as follows: Under the partnership regime, the joint income of A and US is determined for year 1 to be 20,000. The portion of 2,000 which belongs to US is reduced (in the declaration for the joint profit determination) by special expenses incurred by the partner. So again the taxable profit of US for year 1 is 1,000. The tax liability of US for year 1 is 340. US has to settle that tax liability by making a cash payment to the Austrian tax administration of 340. If, in year 2, an amount of 2,000 is transferred into the hands of US, then this is seen as a withdrawal of property and does not constitute a taxable event. No tax withholding applies. The taxable income of A is 18,000 (in year 1) because A's income is reduced by the 2,000 allocated to US.

In specific cases, it may be unclear as to the whether a sleeping partnership should be categorized as the typical or the non-typical form. In order to avoid this classification issue under the Convention, paragraph 8 applies to income from both forms; thus, the income derived by a U.S. sleeping partner with respect to his interest in a sleeping partnership, whether typical or non-typical, is considered business profits under the Convention and subject to tax in Austria to the extent attributable to a permanent establishment in Austria. Under paragraph 8, if the activities carried on by the sleeping partnership constitute a permanent establishment in Austria, the permanent establishment of the partnership is attributed to a U.S. sleeping partner.

Paragraph 9 elaborates on paragraphs 1 and 2 of Article 7, and on the rules in a number of other articles of the Convention that relate to permanent establishment's and fixed bases. These are paragraph 4 of Article 10 (Dividends), paragraph 3 of Article 11 (Interest), paragraph 4 of Article 12 (Royalties), paragraph 3 of Article 13 (Capital Gains), Article 14 (Independent Personal Services) and paragraph 2 of Article 21 (Other Income). Paragraph 9 incorporates the rule of Code section 864(c)(6) into the Convention. It provides that any income or gain attributable to a permanent establishment (or, in the context of the other articles, a fixed base as well) during its existence is taxable in the Contracting State where the permanent establishment (or fixed base) is or was situated even if the payments are deferred until after the permanent establishment (or fixed base) no longer exists.

The effect of this rule can be illustrated by the following example. Assume a company that is a resident of Austria and that maintains a permanent establishment in the United States winds up

the permanent establishment's affairs and sells the permanent establishment's inventory and assets to a U.S. buyer at the end of year 1, in exchange for an interest-bearing installment obligation payable in full by the end of year 3. Despite the fact that Article 13's threshold requirement for U.S. taxation is not met in years 2 or 3, because the company has no permanent establishment in the United States, the United States may tax the deferred income payment received by the company with respect to the installment obligation in year 2 and year 3 under Article 7 (pursuant to the application of paragraph 3 of Article 11 (Interest)).

This Article is subject to the saving clause of paragraph 4 of Article 1 (Personal Scope). Thus, for example, if a citizen of the United States who is a resident of Austria 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 2 of Article 22 (Relief from Double Taxation), tax those profits as part of the worldwide income of the citizen, notwithstanding the provisions of this Article under which such income derived by a resident of Austria is exempt from U.S. tax. The business profits are also subject to the provisions of Article 16 (Limitation on Benefits). For example, assume an Austrian company is doing business in the United States and is earning income effectively connected with a trade or business in the United States, but does not have a permanent establishment in the United States. Under the provisions of Article 7, that company would not be subject to U.S. tax on its business profits. If, however, the company does not qualify for U.S. benefits under Article 16, its income that is effectively connected with its U.S. trade or business would be subject to U.S. tax.

Article 8. SHIPPING AND AIR TRANSPORT

This Article provides rules governing the taxation of profits from the operation of ships and aircraft in international traffic. The term "international traffic" is defined in subparagraph 1(d) of Article 3 (General Definitions) as any transport by a ship or aircraft, except where such transport is solely between places in the other Contracting State.

Paragraph 1 provides that profits of an enterprise of a Contracting State from operating ships or aircraft in international traffic shall be taxable only in that Contracting State. This rule is the same as the rule under the 1956 Convention. By virtue of paragraph 6 of Article 7 (Business Profits), profits of an enterprise of a Contracting State that are exempt in the other Contracting State under this paragraph remain exempt even if the enterprise has a permanent establishment in that other Contract-

ing State.

Paragraph 2 extends the definition of profits from the operation of ships or aircraft in international traffic to include profits from the rental of ships or aircraft on a full (i.e., equipped with crew and supplies) basis or on a bareboat (i.e., without crew and supplies) basis if the ships or aircraft are operated in international traffic by the lessee, or if the rental profits are incidental to profits from the operation of ships or aircraft in international traffic (as described in paragraph 1).

It is understood, consistent with the Commentary to Article 8 of the OECD Model, that income earned by an enterprise from the inland transport of property or passengers within either Contracting State falls within Article 8 if the transport is undertaken as part of the international transport of property or passengers by the enterprise. Thus, if a U.S. shipping company contracts to carry property from Austria to a U.S. city and, as part of that contract, it transports the property by truck from its point of origin to an airport in Austria (or it contracts with a trucking company to carry the property to the airport) the income earned by the U.S. shipping company from the overland leg of the journey would be taxable only in the United States.

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

Paragraph 3 provides that the profits of an enterprise of a Contracting State from the use, rental, or maintenance of containers (including equipment for their transport) used to transport goods in international traffic will be exempt from tax in the other Contracting State. This rule applies regardless of whether the recipient of the income is engaged in the operation of ships or aircraft in international traffic, and regardless of whether the enterprise has a permanent establishment in the other Contracting State. Paragraph 3 applies to an enterprise of a Contracting State regardless of the form of the enterprise. Thus, it applies to a partnership or other pass-through entity to the extent the entity is an enterprise of a Contracting State under the Convention.

The shipping and air transport provisions of the 1956

Convention do not deal with income from the leasing of ships or aircraft, except when such leasing is an occasional source of income for an enterprise engaged in the international operation of ships or aircraft. Also, the 1956 Convention does not deal with income from the use, rental, or maintenance of containers except when such container income is supplementary or incidental to its international operation of ships or aircraft.

Paragraph 4 clarifies that the provisions of the preceding paragraphs apply equally to profits derived by an enterprise of a Contracting State from participation in a pool, joint business, or international operating agency. Therefore, the clarification under paragraph 4 extends to profits from the participation by the pool in the lease of containers which is supplementary or incidental to its international operation of ships or aircraft.

The taxation of gains from the alienation of ships, aircraft or containers is not dealt with in this Article, but in paragraph 5 of Article 13 (Capital Gains).

This Article is subject to the saving clause of paragraph 4 of Article 1 (Personal Scope). The United States, therefore, may, subject to the special foreign tax credit rules of paragraph 2 of Article 22 (Relief from Double Taxation), tax the shipping or air transport profits of a resident of Austria if that Austrian resident is a citizen of the United States. As with any benefit of the Convention, the enterprise claiming the benefit must be entitled to the benefit under the provisions of Article 16 (Limitation on Benefits).

Article 9. ASSOCIATED ENTERPRISES

This Article incorporates into the Convention the general principles of section 482 of the Code. It provides that when associated enterprises engage in transactions that are not at arm's length, the Contracting States may make appropriate adjustments to the taxable income and tax liability of such enterprises to reflect what the income or tax of these enterprises with respect to such transactions would have been had an arm's-length relationship existed.

Paragraph 1 deals with circumstances where an enterprise of a Contracting State is related to an enterprise of the other Contracting State and those related enterprises make arrangements or impose conditions between themselves in their commercial or financial relations that differ from those that would be made between independent persons. Under those circumstances, the Contracting States may adjust the income (or loss) of the enterprises to reflect the income that would have been taken into account in the absence of such a relationship. The paragraph

specifies the meaning of the term "related enterprises" in this context. An enterprise of one Contracting State is related to an enterprise of the other Contracting State if either enterprise participates, directly or indirectly, in the management, control, or capital of the other enterprise. The enterprises are also related if the same persons participate, directly or indirectly, in the management, control, or capital of both enterprises. The term "control" includes any kind of control, whether or not legally enforceable and however exercised or exercisable.

Paragraph 1 contains additional language that clarifies that cost-sharing or general services agreements between associated enterprises are not necessarily to be included among the conditions "made or imposed between two enterprises" referred to in the first sentence of paragraph 1. Thus, the mere presence of a cost-sharing, or similar, agreement between two related parties does not by itself indicate that the two parties have entered into a non-arm's length transaction giving rise to an adjustment under paragraph 1. However, any such arrangement may be examined to determine whether, in fact, it does constitute such a transaction.

Paragraph 2 provides that where a Contracting State has made an adjustment consistent with the provisions of paragraph 1 and the other Contracting State agrees that the adjustment was appropriate, that other Contracting State must make a corresponding adjustment to the tax liability of the related person in that other Contracting State. Where relevant, the Contracting State making such an adjustment will take the other provisions of the Convention into account. For example, if the effect of a corresponding adjustment is to treat an Austrian corporation as having made a distribution of profits to its U.S. parent corporation the provisions of Article 10 (Dividends) will apply, and Austria may impose a 5 percent withholding tax on the dividend. The competent authorities are authorized to consult, if necessary, to resolve any differences in the application of these provisions.

If a corresponding adjustment is made under paragraph 2, it is to be implemented, pursuant to paragraph 2 of Article 24 (Mutual Agreement Procedure), notwithstanding any time limits or other procedural limitations in the law of the Contracting State making the adjustment. The saving clause of paragraph 4 of Article 1 (Personal Scope) does not apply to paragraph 2 of Article 9 (see the exceptions to the saving clause in subparagraphs 5(a) of Article 1). 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 for purposes of implementing a corresponding adjustment. Statutory or procedural limitations, however, cannot be overridden to impose additional tax, because, under subparagraph 2(a) of

Article 1 (General Scope), the Convention cannot restrict any statutory benefit.

Article 9 of the Convention does not contain a counterpart to the paragraph 3 found in many other U.S. income tax treaties. That paragraph is intended to clarify that the rights of the Contracting States to apply internal law provisions relating to adjustments between related parties are fully preserved. Its absence does not signal any change in U.S. law or in the U.S. treaty position. Such adjustments -- the distribution, apportionment, or allocation of income, deductions, credits or allowances, or the characterization of income under thin capitalization rules -- are permitted even if they differ from, or go beyond, those authorized by paragraph 1 of the Article, as long as they accord with the general principles of paragraph 1, i.e., that the adjustments reflect what would have transpired had the related parties been acting at arm's length. Thus, the absence of paragraph 3 does not limit either State's right to implement its own statutory rules related to adjustments intended to reflect transactions between unrelated parties. This conclusion derives from the fact that paragraph 1 is to be interpreted in a permissive, rather than exclusive, manner. For example, while paragraph 1 explicitly allows adjustments to deductions in computing taxable income, it does not preclude adjustments to tax credits if such adjustments can be made under internal law, despite the lack of express authority in Article 9 to make such adjustments.

It is also understood that Article 9 does not limit the rights of the Contracting States to allocate income between related persons in cases where the relationship differs from that described in paragraph 1. This position conforms with the Commentary to the OECD Model, which explicitly states that further adjustments may be needed in circumstances outside of paragraph 1. This rule would apply, for example, if a commercial or contractual relationship allows one party to exercise a controlling influence over another. Any adjustments made pursuant to this provision must accord with the general principles of paragraph 1 of Article 9. The paragraph in the Memorandum of Understanding relating to Article 16 (Limitation on Benefits) and the anti-abuse concepts of the treaty is also relevant for Article 9. The paragraph makes clear that both Contracting States agree that the explicit anti-abuse provisions of the Convention do not limit the applicability of statutory anti-abuse provisions of the Contracting States.

Article 10. DIVIDENDS

Article 10 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. Article 10

also provides rules for the imposition by the United States of a tax on branch profits. Although paragraph 1 establishes that dividends "may be taxed" in the residence country, as noted in the MOU, this rule does not prevent the source State from also taxing such dividends. Generally, the article limits the source State's right to tax dividends and amounts treated as dividends or dividend equivalents.

Under paragraph 1, dividends paid by a company that is a resident of one Contracting State to a shareholder resident in the other Contracting State may be taxed in the State of residence of the recipient. Thus, paragraph 1 preserves the right of each Contracting State to tax dividends derived by its residents from companies resident in the other Contracting State. In the case of the United States, this provision is consistent with the saving clause of paragraph 5 of Article 1 (Personal Scope).

Under Austrian law, Austria generally exempts certain direct investment dividends. Dividends received by a resident company from its nonresident subsidiary are exempt from corporate income tax in the hands of the former, subject to the condition that the recipient company owned 25% or more of the share capital of the distributing company directly and continuously for at least 12 months prior to the end of the taxable year in which the profit distribution was received (KStG 1988. Sec. 10). Dividends which do not qualify for exemption under this participation exemption are normally included in taxable income.

Paragraph 2 limits the right of the source State to tax dividends paid by a company resident in that State if the beneficial owner of the dividends is a resident of the other Contracting State. Under subparagraph 2(a), the source State tax is generally limited to 5 percent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) that holds directly at least 10 percent of the voting stock of the company paying the dividend. Under subparagraph 2(b), the source State tax is limited to 15 percent of the gross amount of the dividends in all other cases. Indirect ownership of voting shares (e.g., through tiers of corporations) and direct ownership of nonvoting shares are not included for purposes of determining eligibility for the 5 percent direct dividend rate. Shares are considered voting shares if they provide the power to elect, appoint or replace the person, or a majority of the board of persons, exercising the powers ordinarily exercised by the board of directors of a U.S. corporation. The Convention does not require that the 10-percent voting interest be held for a minimum period prior to the dividend payment date.

Under the 1956 Convention, direct investment dividends are also taxable by the source State at a maximum rate of 5 percent of the statutory rate of tax otherwise imposed on such dividends,

but the 1956 Convention requires an ownership threshold of 95 percent for the 5 percent rate to apply. Portfolio dividends are subject to source State tax under the 1956 Convention at a rate that is one-half of the rate otherwise applicable. In the base of the United States, this rule results in the application of a 15 percent rate.

Paragraph 2 imposes special limits on the rate of source State taxation for dividends paid by U.S. Regulated Investment Companies and Real Estate Investment Trusts ("RICs" and "REITs"). Because RICs and REITs are generally not liable to corporate tax with respect to distributed amounts, the rate reduction from 15 to 5 percent cannot be justified as a means of relieving multiple levels of corporate tax when the dividend recipient holds a substantial interest in the payer. Dividends paid by RICs are denied the 5-percent direct dividend rate and are subject to the 15-percent portfolio dividend rate (which generally would be applicable to a direct investment in the underlying corporate stock), regardless of the percentage of voting shares held directly by an Austrian corporate recipient of the dividend. Dividends paid by a REIT are generally taxed at source at full statutory rates (reflecting the source State taxation of real property income under Article 6). The fact that notwithstanding paragraphs 1 and 2, the United States may tax most REIT dividends at its statutory 30-percent rate is made clear in the Memorandum of Understanding. However, dividends paid by REITs are taxed at source at the 15-percent portfolio dividend rate if the beneficial owner of the dividend is an Austrian individual who owns less than a 10-percent interest in the REIT.

The denial of the 5-percent withholding rate at source to all RIC and REIT shareholders, and the denial of the 15 percent rate to most shareholders of REITs, is intended to prevent the use of these conduit entities to gain unjustifiable benefits for certain shareholders. For example, an Austrian corporation that wishes to hold a diversified portfolio of U.S. corporate shares may hold the portfolio directly and pay a U.S. withholding tax of 15 percent on all of the dividends that it receives. Alternatively, it may place the portfolio of U.S. stocks in a RIC in which the Austrian corporation owns more than 10 percent of the shares, but in which the corporation has arranged to have a sufficient number of small shareholders to satisfy the RIC diversified ownership requirements. Since the RIC is a pure conduit, there are no U.S. tax costs to the Austrian corporation of interposing the RIC as an intermediary in the chain of ownership. In the absence of the special rules in paragraph 2, however, the interposition would transform portfolio dividends into direct investment dividends, which are taxable at source by the United States at only 5 percent.

Similarly, a resident of Austria may hold U.S. real property

directly and pay U.S. tax either at a 30-percent rate on the gross income or at the ordinary income tax rates specified in Code sections 1 or 11 on net income. As in the preceding example, by placing the real estate holding in a REIT, the Austrian investor could transform real estate income into dividend income, and in the process, absent the special rule, transform, at no tax cost, high-taxed income into much lower-taxed income. In the absence of the special rule, if the REIT shareholder is an Austrian corporation that owns at least a 10-percent interest in the REIT, the withholding rate would be 5 percent; in all other cases it would be 15 percent. In either event, with one exception, a tax of 30 percent or more would be significantly reduced. The exception is the relatively small individual investor who might be subject to a U.S. tax of 15 percent of net income even if he earned the real estate income directly. Under the special rule in paragraph 2, such individuals, defined as those holding less than a 10-percent interest in the REIT, remain taxable at source at a 15-percent rate.

The term "beneficial owner," as used in paragraph 2, is not defined in the Convention, and is, therefore, defined as under the internal law of the country imposing tax (i.e., the source country). The beneficial owner of a U.S. source dividend for purposes of Article 10 is the person to which the dividend income is attributable for tax purposes under the laws of the source state. Thus, if a dividend paid by a U.S. corporation is received by a nominee or an agent that is a resident of Austria on behalf of a person that is not a resident of Austria the dividend is not entitled to the benefits of this Article. However, a dividend received by the nominee on behalf of a resident of Austria would be entitled to the U.S. benefits.

Paragraph 2 does not affect the taxation of the profits of the corporation out of which the dividends are paid.

Paragraph 3 defines the term dividends as used in Article 10 to mean income from shares or other rights, not being debt claims, participating in profits, as well as other income derived from other 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 the distribution is a resident. The definition of dividends also includes income from arrangements, including debt obligations, that carry the right to participate in profits, or that are determined by reference to profits, to the extent that such income is characterized as a dividend under the tax law of the source State. Thus, a constructive dividend that results from a non-arm's-length transaction between a corporation and a related party is a dividend. In the case of the United States the term dividend includes amounts treated as a dividend under U.S. law upon the sale or redemption of shares or upon a transfer of shares in a reorganization. See, e.g., Rev.

Rul. 92-85, 1992-2 CB 69 (sale of foreign subsidiary to U.S. sister company is a deemed dividend to extent of subsidiary's and sister's earnings and profits). Further, a distribution from a U.S. publicly traded limited partnership, which is taxed as a corporation under U.S. law, is a dividend for purposes of Article 10. Under Austrian law, the income from Austrian bonds participating in profits is not characterized as a dividend but rather as interest.

A payment denominated as interest that is made by a thinly capitalized corporation may be treated as a dividend to the extent that the debt is recharacterized as equity under the laws of the source State. Further, if a shareholder lends shares to a third party, the payments by the borrower to the lender in substitution for dividends the lender otherwise would have received also would be treated as dividends.

Paragraph 4 excludes from the rules of paragraphs 1 and 2 dividends effectively connected with a permanent establishment or fixed base of the recipient in the source State. Such dividends will be included in the taxable income of the permanent establishment and taxed on a net basis under the rules of Article 7 (Business Profits) or Article 14 (Independent Personal Services). This rule conforms to the OECD Model. The rule in paragraph 9 of Article 7 (Business Profits) applies to this paragraph as well, so that dividends attributable to a permanent establishment or fixed base, but received after the permanent establishment or fixed base no longer exists, will, nevertheless, be taxable in the Contracting State in which the permanent establishment or fixed base existed.

Paragraph 5 generally bars one Contracting State from imposing any tax on dividends paid by a company resident in the other Contracting State or on the undistributed profits of such company, even if the dividends or profits consist wholly or partly of profits or income arising in that first State. However, exceptions to this rule apply if such dividends are paid to a resident of the first-mentioned Contracting State, or if the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or fixed base situated in the first-mentioned State.

Paragraph 6 provides for the imposition of a branch profits tax by the United States. The paragraph permits the United States to impose an additional tax (i.e., its branch profits tax imposed by section 884(a) of the Code) on a company that is resident in Austria and that has a permanent establishment in the United States, or that is subject to net basis taxation in the United States under Article 6 (Income from Real Property) because the Austrian corporation has elected under Code section 882(d) to treat income from real property not otherwise taxed on a net

basis as effectively connected income, or because the gain arises from the disposition of a United States Real Property Interest other than an interest in a United States corporation. Such additional tax may be imposed only on the portion of the business profits of the Austria company that is attributable to the permanent establishment and the portion of net income that is subject to tax under Article 6 or paragraph 1 of Article 13 that represents the dividend equivalent amount. For this purpose, "dividend equivalent amount" has the same meaning it has under U.S. law, as amended from time to time without changing the general principle thereof. It is understood that the concept of dividend equivalent amount is intended to approximate the portion of the income referred to above that would be distributed as a dividend if such income were earned by a U.S. subsidiary of the Austrian company. The United States may not impose its branch tax on the business profits of an Austrian corporation that are effectively connected with a U.S. trade or business but that are not attributable to a permanent establishment and are not otherwise subject to U.S. taxation under Article 6 or paragraph 1 of Article 13.

Austria does not impose a branch tax under its law, and, therefore, saw no need to preserve an Austrian right to impose such a tax under the treaty.

Paragraph 7 provides that the branch profits tax permitted by paragraph 6 shall not be imposed at a rate exceeding the direct dividend withholding rate specified in subparagraph 2(a), which is five percent.

Notwithstanding the foregoing limitations on source State taxation of dividends, the saving clause of paragraph 4 of Article 1 (Personal Scope) permits the United States to tax dividends received by its residents and citizens, subject to the special foreign tax credit rules of paragraph 2 of Article 22 (Relief from Double Taxation), as if the Convention had not come into effect. The benefits of this Article are available to a resident of a Contracting State only if that resident qualifies for benefits under the provisions of Article 16 (Limitation on Benefits).

Article 11. INTEREST

Article 11 provides rules for source and residence State taxation of interest.

Paragraph 1 grants to the residence State the exclusive right to tax interest derived and beneficially owned by its residents. Thus, this Convention generally preserves the exemption at source for interest provided in the 1956 Convention. As in the case of Article 10 (Dividends), the source State shall

treat as the beneficial owner of such income the person to which the income is attributable for tax purposes under the laws of the source State. Interest arising in a Contracting State and paid to a nominee or agent that is a resident of the other Contracting State therefore may be taxed in the State of source if the beneficial owners are not residents of the other Contracting State (subject to the provisions of any applicable treaty between the State of source and the State of residence of the beneficial owner).

Paragraph 2 defines the term "interest" as used in the Convention to include, inter alia, income from debt claims of every kind, whether or not secured by a mortgage, and whether or not carrying a right to participate in the debtor's profits. The term includes, in particular, income from government securities and income from bonds or debentures, including premiums or prizes attaching to these instruments. Penalty charges for late payment are not defined as interest, but an excess inclusion with respect to a residual interest in a real estate mortgage investment conduit is defined as interest (see paragraph 5). Any income dealt with in Article 10 is also excluded from the definition of interest. Thus, for example, if under domestic law of the source State, income from a debt obligation carrying the right to participate in profits is treated as a dividend, it is also treated as a dividend under paragraph 3 of Article 10 and is not covered by Article 11. Such income that is not treated as a dividend under the law of the source State, however, remains within the definition of interest Under Article 11.

Paragraph 3 provides an exception from the source-State exemption rule of paragraph 1 in cases where the beneficial owner of the interest carries on business through a permanent establishment in the source State or performs independent personal services from a fixed base situated in the source State and the debt claim in respect of which the interest is effectively connected with the permanent establishment or fixed base. In such cases, the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services) will apply and the source State will generally retain the right to impose tax on a net basis on such interest income. This rule conforms to the OECD Model. The rule in paragraph 9 of Article 7 (Business Profits) applies to this paragraph as well, so that interest attributable to a permanent establishment or fixed base, but received after the permanent establishment or fixed base no longer exists, will, nevertheless, be taxable in the Contracting State in which the permanent establishment or fixed base existed.

Paragraph 4 limits the benefits of this Article to interest amounts that reflect arm's length transactions. If the interest paid exceeds an arm's length amount due to a special relationship between the debtor and creditor, then any excess amount of

interest paid remains taxable according to the laws of the source State 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, but the tax would be subject to the rate limitations of paragraph 2 of Article 10 (Dividends).

Paragraph 5 provides exceptions to the general exemption from source-State taxation of interest. Paragraph 5(a) permits the United States to impose its statutory rate of tax (currently 30 percent) on an excess inclusion with respect to a residual interest of an Austrian resident in a U.S. real estate mortgage investment conduit (REMIC), notwithstanding the provisions of paragraphs 1 and 2 that generally exempt interest from taxation at source. The legislation that created REMICs in 1986 provided that such excess inclusions were to be taxed at the full 30-percent statutory rate, regardless of any then-existing treaty provisions to the contrary. Providing for the 30-percent rate in the Convention, therefore, conforms to Congressional intent the treatment of excess inclusions with respect to residents of Austria. It is consistent with the policy of Code sections 860E(e) and 860G(b) that excess inclusions with respect to a real estate mortgage investment conduit (REMIC) should bear full U.S. tax in all cases. Without a full tax at source, foreign purchasers of residual interests would have a competitive advantage over U.S. purchasers at the time these interests are initially offered. Also, absent this rule, the U.S. would suffer a revenue loss with respect to mortgages held in a REMIC because of opportunities for tax avoidance created by differences in the timing of taxable and economic income produced by these interests.

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

The Article does not refer to the excess of the amount of interest deductible by a permanent establishment of an Austrian

company in the United States over the interest actually paid by such permanent establishment (i.e., the excess interest portion of the branch level interest taxes imposed by section 884(f) of the Code). Since this amount is treated as interest derived and beneficially owned by the resident of Austria, the Article 11 exemption from source country taxation will generally prevent the collection of this excess interest tax.

Notwithstanding the foregoing limitations on source State taxation of interest, the saving clause of paragraph 4 of Article 1 (Personal Scope) permits the United States to tax its residents and citizens, subject to the special foreign tax credit rules of paragraph 2 of Article 22 (Relief from Double Taxation, as if the Convention had not come into force. As with all benefits under this Convention, the granting of benefits under this Article is subject to the requirement that the beneficial owner of the interest income qualify for benefits under the provisions of Article 16 (Limitation on Benefits).

Article 12. ROYALTIES

Article 12 provides rules for source and residence country taxation of royalties.

Paragraph 1 provides the general rule that royalties derived and beneficially owned by a resident of a Contracting State shall be taxable only in that State. Except for motion picture royalties, which are dealt with in paragraph 2, the residence state has the exclusive right to tax royalties derived and beneficially owned by its residents. The source State shall treat the recipient of royalties as the beneficial owner of such royalties for purposes of Article 12 if the recipient is the person to which the income is attributable for tax purposes under the laws of the source State.

Paragraph 2 contains an exception to the exemption at source provided in paragraph 1. The source State may tax royalties that constitute consideration for the use of, or the right to use, motion picture films, or films, tapes or other means of reproduction used for radio or television broadcasting, but at a rate not above 10 percent of the gross amount of the royalty. The reference to "other means of reproduction" clarifies that the 10-percent tax at source will apply to payments resulting from the use of means of reproduction that reflect future technological advances in the field of radio and television broadcasting.

The source treatment for royalties in the 1956 Convention (i.e., exemption at source for most royalties and source taxation at a rate of 10 percent for motion picture royalties) is carried forward to the Convention.

Paragraph 3 defines the term "royalties" as used in the Convention as 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; for the use of, or the right to use, any patent, trademark, design or model, plan, secret formula or process, or other like right or property; or for the use of, or the right to use, information concerning industrial, commercial, or scientific experience. Royalties also include gains derived from the alienation of any such right or property that are contingent on the productivity, use, or further alienation thereof.

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

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

Computer software generally is protected by copyright laws around the world. Under the Convention, whether payments for the use or the right to use computer software are treated as royalties or as business profits will depend on the facts and circumstances of the transaction. Payments received in connection with the transfer of so-called "shrink-wrap" computer software are treated as business profits.

Paragraph 4 excludes from the scope of this Article royalties effectively connected with a permanent establishment or fixed base of the beneficial owner in the source State. In such cases the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services) will apply and the source State will generally retain the right to tax such royalties. The rule in paragraph 9 of Article 7 (Business Profits) applies to this paragraph as well, so that royalties attributable to a permanent establishment or fixed base, but received after the permanent establishment or fixed base no longer exists, will, nevertheless, be taxable in the Contracting State in which the permanent establishment or fixed base existed.

Paragraph 5 limits the benefits of this Article to royalty amounts that reflect arm's-length transactions. It provides that

in cases involving special relationships between the payor and beneficial owner of a royalty, Article 12 applies only to the extent of royalty payments that would have been made absent such special relationships. Any excess amount of royalties paid remains taxable according to the laws of the source State with due regard to the other provisions of the Convention. If, for example, the excess amount is treated as a distribution of profits under the national law of the source State, such excess amount will be taxed as a dividend rather than as a royalty payment, and the tax imposed on the dividend will be subject to the rate provided in subparagraph 2(a) of Article 10 (Dividends).

Paragraph 6 contains the source rule for royalty payments. Under this rule, a royalty arises in a Contracting State to the extent it is a payment for the use of, or the right to use, rights or property within that State. This source rule is relevant for the implementation of paragraph 2. If, for example, a U.S. resident is the beneficial owner of a royalty paid by a resident of Austria for the exhibition of a motion picture in Austria, that royalty is sourced in Austria and is subject to a 10 percent withholding tax in Austria. If, however, the payment, even if made by an Austrian resident, is for the exhibition of a motion picture in Germany, or in the United States, the royalty would not be Austria source income, and would not be subject to Austrian tax.

Notwithstanding the foregoing limitations on source State taxation of royalties, the saving clause of paragraph 4 of Article 1 (Personal Scope) permits the United States to tax its citizens, subject to the special foreign tax credit rules of paragraph 2 of Article 22 (Relief from Double Taxation), and its residents as if the Convention had not come into effect. As with all benefits under this Convention, the granting of benefits under this Article is subject to the requirements that the beneficial owner of the royalty income qualify for benefits under the provisions of Article 16 (Limitation on Benefits).

Article 13. GAINS

Article 13 provides rules for source and residence country taxation of gains from the alienation of property.

Paragraph 1 preserves the source country right to tax gains derived from the alienation of real property situated in the source (i.e., situs) state. Thus, paragraph 1 permits gains derived by a resident of one Contracting State from the alienation of real property, referred to in Article 6 (Income from Real Property) and situated in the other Contracting State to be taxed by such other Contracting State.

For purposes of paragraph 1, paragraph 2 defines "real property situated in the other Contracting State" to include real property referred to in Article 6 (i.e., interests in the real property itself) and certain indirect interests in real property. The term is defined separately for the United States and Austria, to allow use of the U.S. statutory term "United States real property interest." Indirect interests include shares or comparable interests in a company the assets of which consist or consisted wholly or principally of real property situated in the source state. In addition, for United States, but not Austrian, purposes, interests in a partnership, trust, or estate, to the extent that the assets of such entity consist of real property situated in the source state, are included in this definition of real property situated in the other Contracting State. It is clear that in all events the term "real property situated in the other Contracting State" includes a United States real property interest, and the specified partnership, trust or estate interests, when the United States is the other Contracting State. Thus, the United States preserves its right to collect the tax imposed under the Foreign Investment in Real Property Tax Act (section 897 of the Code) on gains derived by foreign persons from the disposition of United States real property interests. For this purpose, the source rules of section 861(a)(5) of the Code shall determine whether a United States real property interest is situated in the United States.

Because the definition of "real property situated in the other Contracting State" contained in paragraph 2 is specifically limited to the interpretation of paragraph 1, such definition has no effect on the right to tax income covered in other articles. For example, the inclusion of interests in certain corporations in the definition of real property situated in the other Contracting State for purposes of permitting source country taxation of gains derived from dispositions of such interests under this Article does not affect the treatment of dividends paid by such corporations. Such dividends remain subject to the limitations on source country taxation contained in Article 10 (Dividends) and are not governed by the unlimited source country taxation right contained in Article 6 with respect to immovable property.

Paragraph 3 preserves the source country's right to tax gains from the alienation of personal property in certain circumstances. It provides that the other Contracting State (the source state) may tax gains from the alienation of personal property forming part of the business property of a permanent establishment that an enterprise of a Contracting State has in the other State or of personal property pertaining to a fixed base available to a resident of a Contracting State in the other 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. The rule in paragraph 9 of Article 7 (Business Profits) applies to paragraph 3 as well, so that the Contracting State in which the permanent establishment existed may tax gains from the alienation of personal property forming part of the business property of a permanent establishment or pertaining to a fixed base that are received after the permanent establishment or fixed base no longer exists.

This provision permits gains from the alienation by a resident of a Contracting State of an interest in a partnership, trust, or estate that has a permanent establishment situated in the other Contracting State to be taxed as gains attributable to such permanent establishment under paragraph 3. Thus, for example, the United States may tax gains derived from the disposition of an interest in a partnership that has a permanent establishment in the United States, whether or not the assets of the partnership consist of real property as defined in Article 13.

Paragraph 4 contains a rule to coordinate the interaction of Code section 864(c)(7) with the analogous provision of Austrian law. Under the Code rule, if an asset which had been part of the business property of a U.S. trade or business (or, in a treaty context, of a permanent establishment or fixed base in the United States) is alienated within ten years of its removal from the U.S. trade or business (or permanent establishment/fixed base), the gain realized on such alienation is subject to U.S. tax.

Austria's income tax act (Section 6, subparagraph 6) provides that a transfer of property used in a permanent establishment in Austria to a permanent establishment outside of Austria is a taxable event.

Paragraph 4 provides that gain that accrued during the time an asset formed part of the business property of a permanent establishment or fixed base that a resident of a Contracting State has or had in the other Contracting State may be taxed in the other State, but only to the extent of the gain that accrued during the time the asset formed part of the business property of a permanent establishment or fixed base that the resident has or had in that other State. Thus, for example, with regard to the transfer of appreciated assets from a U.S. company's permanent establishment in Austria to a permanent establishment in a third country, paragraph 4 would coordinate and modify the application of U.S. and Austrian law.

With regard to the sale of appreciated assets by an Austrian company, the U.S. may tax the gain to the extent accrued during the time the asset formed part of the business property of a permanent establishment that the Austrian company has or had in the United States. This is a limitation on the amount of the

gain that is taxable under section 864(c)(7) of the Code. Further, although this rule does not impose a time limitation to the U.S. right to tax the gain, under section 864(c)(7), the United States may not tax a gain that is realized after the ten-year period has lapsed.

The provision also restricts the application of U.S. laws to U.S. citizens and residents that had property in an Austrian permanent establishment or fixed base to the extent that Austria taxed the gain in accordance with this paragraph. Under the provision, the residence State of the taxpayer must exclude from the income that it subjects to tax any amount of gain that has been taxed, in accordance with paragraph 4, by the State in which the permanent establishment or fixed base is, or was, located. Thus, for example, if a U.S. person alienates an asset that at one time formed part of the business property of a permanent establishment of that person in Austria, and if the total gain is $100, and $25 of that gain accrued during the time that the asset was part of the Austrian permanent establishment, Austria will have taxed $25 of the gain at the time the asset was removed from Austria, and the United States may tax the remaining $75 of gain at the time of alienation.

Paragraph 5 provides that gains derived by an enterprise of a Contracting State from the alienation of ships, aircraft or containers used in international traffic shall be taxable only in that Contracting State. Consistent with the definition of containers provided in paragraph 3 of Article 8, containers include trailers, barges, and related equipment for the transport of containers. Thus, such gains are taxable on the same basis as income from the operation of ships or aircraft under Article 8 (Shipping and Air Transport).

Paragraph 5 also provides that those gains that are included within the definition of royalties in paragraph 3 of Article 12 (Royalties) will be subject to the rules of that Article, and not Article 13. The gains referred to are those derived from the alienation of any right or property that gives rise to royalties that are contingent on the productivity, use, or further alienation thereof. The source country will either exempt such gains or tax them at not more than 10 percent, in accordance with Article 12.

Paragraph 6 provides that gains from the alienation of property other than property referred to in paragraphs 1 through 5 are taxable only in the Contracting State of which the alienator is a resident. Thus, gain from the sale of corporate securities or other tangible personal property not covered in paragraphs 3 and 4 is exempt from tax at source.

Under the Austrian tax law for the reorganization of

enterprises, if a foreign corporation has a permanent establishment in Austria and transfers permanent establishment assets into a subsidiary, Austria will tax the appreciation in the assets on incorporation unless the shares remain subject to Austrian tax. This is consistent with paragraph 3, which permits the Contracting State in which the permanent establishment is located to tax gains on the alienation of personal property forming part of the business property of the permanent establishment.

In the reverse case, with regard to the transfer of appreciated assets of an Austrian company's permanent establishment in the United States to a U.S. subsidiary, paragraph 3 also would permit the United States to tax such gains. However, the transaction may not be taxable under the corporate reorganization provisions of the Internal Revenue Code (section 351 and related provisions).

Paragraph 7 provides that where property was transferred by a resident of the United States to an Austrian company as a capital contribution and, in application of the Austrian Reorganization Tax Act (Umgruendungssteuergesetz), no capital gains taxation took place, a subsequent alienation of the respective shares in the Austrian company that takes place through the year 2010 shall remain taxable in Austria. This rule applies to the disposition of stock that was received on the incorporation of a permanent establishment in Austria if the capital gains were not taxed on the incorporation of the subsidiary.

The operation of paragraph 7 is illustrated by the following example. A U.S. corporation (A) has a permanent establishment in Austria, with assets having a tax basis of 1,000 and a net market value of 5,000. Thus, the permanent establishment represents a business with untaxed (hidden) reserves of 4,000. Assume that, in 1996 (or in any year thereafter before 2011), the Austrian permanent establishment is transformed into an Austrian company (B). This can be arranged under the current Austrian tax regime tax free, which means that the assets of the permanent establishment will be incorporated into the financial accounts of the new company at 1,000. Correspondingly, the shares held by A in the newly created Austrian company B will be valued for tax purposes at 1,000. If the shares were sold in 1999 (assume for 5,500), then this transaction would be taxable in Austria (capital gain: 4,500). In case the sales price is only 4,000, the capital gain would be 3,000.

Under these same facts, except that another form of alienation is chosen, such as a contribution of the shares into the U.S. or Austrian company (X) before the year 2011, the result would be the same; the capital gain would be taxable in Austria

because, if X subsequently sells its stock to company Z, this transaction could not be taxed any more under the new treaty even within the interim period ending in 2010.

Under these same facts, except that the stock of B is sold or otherwise alienated after year 2010, the transaction would not be taxable in Austria.

In the event that a transfer of stock is treated as an "alienation" for Austrian tax purposes and double taxation results, it is expected that any such double taxation would be addressed under competent authority procedures.

Notwithstanding the foregoing limitations on source State taxation of certain gains, the saving clause of paragraph 4 of Article 1 (Personal Scope) permits the Contracting States to tax their citizens and residents as if the Convention had not come into effect. The rules of paragraph 4 of this Article, however, continue to apply to the citizens and residents of a Contracting State by virtue of the exceptions to the saving clause of paragraph 5 of Article 1. As with all benefits under this Convention the granting of benefits under this Article is subject to the requirement that the beneficial owner of the income qualify for benefits under the provisions of Article 16 (Limitation on Benefits).

Article 14. INDEPENDENT PERSONAL SERVICES

The Convention provides separate articles dealing 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 dependent personal services. Modifications to these general rules are provided for the performance income of artistes and athletes (Article 17); pensions in respect of personal service income, social security benefits, annuities, alimony, and child support payments (Article 18); government service salaries (Article 19); and income of students and business trainees (Article 20).

Article 14 provides the general rule that income derived by an individual who is a resident of a Contracting State from the performance of personal services in an independent capacity shall generally be taxable only in that State. However, such income may be taxed in the other Contracting State if the services are performed there and the income is attributable to a fixed base that is regularly available to the individual in that other State for the purpose of performing his activities.

The Convention does not define the term "fixed base," but its

meaning is understood to be analogous to that of the term "permanent establishment," as defined in Article 5 (Permanent Establishment) similarly, the rules of Article 7 (Business Profits) for attributing income and expenses to a permanent establishment are generally relevant for attributing income to a fixed base. However, the taxing right conferred by this Article with respect to income from independent personal services is somewhat more limited than that provided in Article 7 for the taxation of business profits. In both articles the income of a resident of one Contracting State must be attributable to a permanent establishment or fixed base in the other for that other State to have a taxing right. In Article 14, in addition, the income must be attributable to services performed in that other State, while Article 7 does not require that all of the income generating activities be performed in the State where the permanent establishment is located.

The Article does not define the term "personal services in an independent capacity." The term, however, is understood to include all personal services performed by an individual for his own account, whether as a sole proprietor or a partner, where he receives the income and bears the risk of loss arising from the services. Income from services in which capital is a material income producing factor will, however, generally be governed by the provisions of Article 7 (Business Profits). The taxation of income of an individual from those types of independent services that are covered by Articles 17 through 20 is governed by the provisions of those articles. There is no Article in the Convention that deals specifically with directors' fees. Such fees paid to "outside-directors" are covered by this Article.

The rule in paragraph 9 of Article 7 (Business Profits) applies to Article 14 as well. That rule clarifies, in the context of Article 14, that income which is attributable to, a fixed base but is deferred and received after the fixed base no longer exists, may nevertheless be taxed by the State in which the fixed base was located. Thus, the tax cannot be avoided by deferring the payment.

The taxing rule in paragraph 1 of the Article differs significantly from that in the 1956 Convention. Under Article X of that Convention, the host State exempted from tax income from independent personal services performed by a resident of the other State if the person performing the services was present in the host State for a period or periods aggregating not more than 183 days in the taxable year, and either the individual was performing his services under contract with a resident of the individual's State of residence, and the compensation was borne by that person, or the compensation did not exceed $3,000. The new Convention does not examine the length of time or compensation received but, instead, considers whether the income received

from independent personal services performed is attributable to a fixed base.

If the individual is an Austrian resident who performs independent personal services in the United States, and the individual is also a U.S. citizen, the United States may, by virtue of the saving clause of paragraph 4 of Article 1 (Personal Scope) tax the individual's income without regard to the restrictions of this Article, subject to the special foreign tax credit rules of paragraph 2 of Article 22 (Relief from Double Taxation).

Article 15. DEPENDENT PERSONAL SERVICES

This Article deals with the taxation of remuneration derived by a resident of a Contracting State as an employee.

Under paragraph 1, employment income derived by an individual who is a resident of a Contracting State may be taxed in the State of residence. To the extent the remuneration is derived from an employment exercised in the other Contracting State (the "host country"), the remuneration may also be taxed by the host country, subject to the conditions specified in paragraph 2.

The provisions of this paragraphs apply, subject to the provisions of Articles 18 (Pensions) and 19 (Government Service). Thus, if a person is exempt from tax in the host country under the provisions of Articles 18 or 19 (e.g., the person is performing Government service on behalf of one State in the other) he cannot be subject to host country tax under paragraph 1 of this Article even though his employment is exercised in the host country. Article 17 (Artistes and Athletes) specifies that its provisions apply notwithstanding the provisions of this Article. Thus, for example, a resident of one Contracting State, who is a member of a football team that plays in the other Contracting State, and who earns over $20,000 in a taxable year from his performances in the other State will be subject to host country tax on his employment income even if he would otherwise be exempt under Article 15.

Paragraph 2 specifies the conditions under which, even where the remuneration of a resident of a Contracting State (described in paragraph 1) is derived from sources within the other Contracting state (i.e., the services are performed there), that other State may not tax the remuneration. The host country may not tax if three conditions are satisfied: (1) the individual is present there for a period or periods not exceeding, in the aggregate, 183 days in any 12-month period beginning or ending in the fiscal year concerned; (2) the remuneration is paid by, or on behalf of, an employer who is not a resident of the host country; and (3) the remuneration is not borne as a deductible expense by

a permanent establishment or fixed base that the employer has in the host country.

The first condition is taken from the 1992 OECD Model. In previous OECD Models, the 183-day period covered only the fiscal year concerned. This permitted an abuse under which an employee could remain in a country for the last 5 1/2 months of one fiscal year and the first 5 1/2 months of the next and fail to meet the test for taxability in the host country. The language of sub-paragraph 2(a) prevents that abuse.

The 183-day period in condition (a) is to be measured using the "days of physical presence" method. Under this method, the days that are counted include any day in which a part of the day is spent in the host country. (Rev. Rul. 56-24, 1956-1 C.B. 851.) Thus, days that are counted include the days of arrival and departure; weekends and holidays on which the employee does not work but is present within the country; vacation days spent in the country before, during or after the employment period, unless the individual's presence before or after the employment can be shown to be independent of his presence there for employment purposes; and time during periods of sickness, training periods, strikes etc., when the individual is present but not working. If illness prevented the individual from leaving the country in sufficient time to qualify for the benefit, those days will not count. Also, any part of a day spent in the host country while in transit between two points outside the host country is not counted. These rules are consistent with the description of the 183-day period in paragraph 5 of the Commentary to Article 15 in the OECD Model.

Conditions (2) and (3) are intended to assure that a Contracting State will not be required both to allow a deduction to the employer for the salary paid and to exempt the employee on the amount received. 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 (2) nor (3), as the case may be, will be considered to have been fulfilled. 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. The "regular complement" includes the crew. In the case, for example, 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.

A U.S. citizen resident in Austria who performs dependent services in the United States and meets the conditions for U.S. exemption under paragraph 2, or a U.S. citizen or resident who is a crew member on an Austrian ship or airline, and would, therefore, be exempt from U.S. tax under paragraph 3 were he not a U.S. citizen or resident, is, nevertheless, taxable in the United States on his remuneration by virtue of the saving clause of paragraph 4 of Article 1 (Personal Scope), subject to the special foreign tax credit rule of paragraph 2 of Article 22 (Relief from Double Taxation).

Article 16. LIMITATION ON BENEFITS

Article 16 addresses the problem of "treaty shopping." The Article ensures that only those persons intended to benefit from the Convention -- residents of the other Contracting State -- do so, by not granting benefits that will ultimately enure to the benefit of residents of third States that do not have a substantial business in, or business nexus with, that other Contracting State.

In a typical case of treaty shopping, a resident of a third State wants to derive treaty-favored income from one of the Contracting States, but has no treaty, or has an unfavorable treaty, with that State. The third-country resident would establish an entity resident in the other Contracting State principally for the purpose of deriving income from the first-mentioned Contracting State and claiming treaty benefits with respect to that income. Article 16 seeks to deny benefits to such persons by limiting the benefits of the Convention to those persons whose residence in a Contracting State is unlikely to have been motivated by the existence of the Convention.

Absent Article 16, the entity described in the preceding paragraph generally would be entitled to benefits as a resident of a Contracting State, subject, however, to anti-abuse provisions (e.g., business purpose, substance-over-form, step transaction or conduit principles) that may apply to the transaction or arrangement under the domestic law of the source State. As noted in the Memorandum of Understanding, Article 16 and the anti-abuse provisions of domestic law complement each other, as Article 16 generally determines whether an entity has sufficient nexus to the Contracting State to be treated as a resident for treaty purposes, while domestic anti-abuse provisions determine whether a particular transaction should be

recast in accordance with the substance of the transaction.

The structure of the Article is as follows: Paragraph 1 lists a series of attributes, any one of which will entitle a person who is a resident of a Contracting State to some or all of the benefits of the Convention in the other Contracting State. These tests are essentially objective tests. Paragraph 2 provides that benefits may be granted, even to a person not entitled to benefits under the tests of paragraph 1, if the competent authority of the State in which the relevant income arises so determines. Paragraph 3 defines the term "recognized stock exchange." Paragraph 4 addresses "triangular cases." Paragraph 5 authorizes the competent authorities to develop agreed applications and to exchange information necessary for carrying out the provisions of the Article.

The negotiators developed a Memorandum of Understanding indicating how the provisions of the Article are to be understood both by the competent authorities and by taxpayers in the Contracting States. It is anticipated that as the competent authorities and taxpayers gain more experience with the concepts in this Article further guidance will be developed and made public.

The Memorandum of Understanding discusses the anti-abuse concept of the treaty, making the point that the treaty provisions designed to curb abusive international transactions and to exclude income from those transactions from treaty benefits do not prevent a Contracting State from applying a "substance over form" evaluation of the facts in cases not specifically covered by an anti-abuse clause in the treaty. The phrase "substance over form" is understood to refer to the process of looking at the economic substance of a transaction or event rather than solely at its legal form. This process also encompasses the notion of taking into account the economic consideration that underlies the transactions or event.

Under subparagraphs (a) and (b) of paragraph 1, two categories of persons eligible for benefits from the other Contracting State are (1) individual residents of a Contracting State and (2) the Contracting States, political subdivisions or local authorities thereof. It is unlikely that a person falling into one of these categories can be used to derive treaty-benefitted income as the beneficial owner of the income on behalf of a third-country person. If an individual receives 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 those articles require that the beneficial owner of the income be a resident of a Contracting State.

Subparagraph 1(c) describes the "active trade or business"

and the "substantiality" test for eligibility for benefits. This subparagraph looks not at objective characteristics of the person deriving the income, but at the nature of the activity engaged in by that person and the connection between the income and that activity. Under this test, a resident of a Contracting State deriving an item of income from the other Contracting State is entitled to benefits with respect to that item of income if the person is engaged in an active trade or business in the State of residence and the item of income in question is derived in connection with, or is incidental to, that trade or business. If the income is derived in connection with the trade or business, rather than being incidental to it, the trade or business must be substantial in relation to the income generating activity in the other State. The substantiality test is needed to support the connection between the income and the active trade or business. The test for incidental activity does not require substantiality. 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.

In general, it is expected that if a person qualifies for benefits under the other subparagraphs of paragraph 1, no inquiry will be made into qualification for benefits under subparagraph 1(c). Upon satisfaction of any of the other tests of paragraph 1, any income derived by the beneficial owner from the other Contracting State is entitled to treaty benefits. Under subparagraph 1(c), however, the test is applied separately for each item of income.

The Memorandum of Understanding describes the understandings reached by the negotiators on the intended scope of subparagraph 1(c) and illustrates some of these understandings by means of examples. The examples are not intended to be exhaustive, but merely to illustrate the kinds of considerations relevant in determining whether a particular case falls within the scope of subparagraph 1(c).

The Memorandum of Understanding also describes how the negotiators agreed to interpret certain terms used in subparagraph 1(c). A person resident in one of the States will be considered to be engaged in an active trade or business not only if such person is directly so engaged, but also if the person:

(i) is a partner in a partnership;

(ii) is under the beneficial control of a single person engaged in an active trade or business in that State;

(iii) is under the beneficial control of a group of five or

fewer persons each member of which is engaged in activity in that State that is a component part of or directly related to the trade or business in that State;

(iv) is a company that is a member of a group of companies that forms, or could form, a consolidated group for tax purposes under domestic law (as applied without regard to the residence of such companies) and the group is engaged in an active trade or business in that State;

(v) owns, either alone or as a member of a group of five or fewer persons that are qualified persons or residents of an "identified state," a controlling beneficial interest in a person engaged if an active trade or business in the owner's State of residence; or

(vi) is together with another person that is so engaged, under the common control of a person or a group of five or fewer persons that (or, in the case of a group, each member of which) is a qualified person or a resident of an "identified state."

The Memorandum of Understanding defines an "identified state" as any third country that the competent authorities agree has effective exchange of information provisions with the State being requested to give treaty benefits. It defines "income derived in connection with or incidental to" a trade or business as income that comes from a line of business (or assets that are part of that business) in Austria that forms part of a business conducted in the United States, or vice versa.

The Memorandum of Understanding clarifies, principally through the use of a number of examples, what is meant by the term "substantial." In the case of an Austrian resident deriving income from an active trade or business in the United States carried on by a related person, for that Austrian trade or business to be considered substantial in relation to the income-generating activity in the United States, it is not necessary that the trade or business be as large as the U.S. income-generating activity. The Austrian trade or business cannot, however, in terms of gross income, assets, or similar measures, be only a very small percentage of the U.S. activity.

The substantiality requirement is intended to prevent an abuse of the active trade or business test. For example, a third-country resident may want to acquire a U.S. motion picture company. If its country of residence has no tax treaty with the United States, any dividends generated by the investment would be subject to a 30-percent U.S. withholding tax. Absent a substantiality test, the investor could set up an Austrian corporation that would operate a small video-rental outlet in Austria to rent a few videos of the movies produced by the U.S. company. That

Austrian corporation would then acquire the U.S. production company with capital provided by the third-country resident. It might be argued that the U.S.-source income is generated from business activities in the United States related to the video-rental activity of the Austrian parent and that the dividend income should be subject to U.S. tax at the 5-percent rate provided in Article 10 (Dividends). However, the substantiality test would not be met in this example, so the dividends would remain subject to the 30-percent withholding tax in the United States.

In addition to this subjective facts and circumstances approach to interpreting substantiality, the Memorandum of Understanding provides a safe-harbor standard. Under the safe harbor, in general, an activity in a State will be deemed substantial in relation to the income-producing activity in the other State if the ratios of the assets used in the first-mentioned State, gross income derived from the active business in that State, and payroll expense for services performed in that State to the assets, gross income, and payroll expense, respectively, for services performed in the other Contracting State each exceed 7.5 percent and the average of the three ratios exceeds 10 percent. If ratio for any factor fails the 7.5-percent test, the average ratio for the preceding three years may be substituted for that factor. A similar test applies in the recent U.S.-France income tax treaty, the U.S.-Netherlands income tax treaty, and the proposed U.S.-Luxembourg income tax treaty.

Since the term "gross income" is not defined in the Convention, in determining whether a person deriving income from U.S. sources is entitled to the benefits of the Convention, in accordance with paragraph 2 of Article 3 (General Definitions), the United States will ascribe the meaning to the term that it has under U.S. law. Thus, in general, the term should be understood to mean gross receipts (net of returns and allowances) less the cost of goods sold. The cost of sales and operations, or cost of goods sold, includes the sum of the direct materials, direct labor, and overhead costs related to producing, acquiring, storing, and handling the inventories sold during a period. Overhead costs allocable to inventory include depreciation, property taxes paid, amortization, employee retirement plan expenses, or other supervisory, general, and administrative (SG&A) expenses, to the extent these costs directly benefit or are incurred by reason of inventory operations. The cost of goods sold does not include expenses associated with advertising, promotion, sales and marketing, or operating costs not related to inventory operations.

Subparagraph 1(d) provides a two-part test, ownership and base erosion, both of which must be met for benefits to be granted under this subparagraph. Under these tests, benefits

will be granted to a resident of a Contracting State if both (1) more than 50 percent of the beneficial interest in the person (or, in the case of a corporation, more than 50 percent of each class of its shares) is owned, directly or indirectly, by persons who are themselves entitled to benefits under the other tests of paragraph 1 (other than subparagraph (c)), or by U.S. citizens, and (2) not more than 50 percent of the person's gross income is used, directly or indirectly, to make deductible payments to persons who are not themselves eligible for benefits under the other tests of paragraph 1 (other than subparagraph (c)), or who are not U.S. citizens.

The rationale for this two-part test is that since 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, merely requiring substantial ownership of the entity by treaty country residents or U.S. citizens is not sufficient to prevent such benefits from flowing substantially to third-country residents. It is also necessary to require that the entity's deductible payments be made to such treaty country residents or their equivalents. For example, a third-country resident could lend funds to an Austrian-owned Austrian corporation to be on-lent to the United States. The U.S.-source interest income of the Austrian corporation would be exempt from U.S. withholding tax under Article 11 (Interest). While the Austrian corporation would be subject to Austrian corporation 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 Austria and the third country, that interest income is exempt from Austrian tax, the U.S. treaty benefit with respect to the U.S.-source interest income will have flowed to the third-country resident inappropriately, with no reciprocal benefit to the United States from the third country.

Under subparagraph 1(e) a company that is a resident of a Contracting State is entitled to treaty benefits from the other Contracting State if there is substantial and regular trading in the company's principal class of shares on a recognized stock exchange. Paragraph 3 defines the term "recognized stock exchange" as the NASDAQ System and any stock exchange registered as a national securities exchange with the U.S. Securities and Exchange Commission, and the Vienna stock exchange. Paragraph 3 also provides that the competent authorities may, by mutual agreement, recognize additional exchanges for purposes of subparagraph 1(e). The Contracting States intend that the term "principal class of shares" is to be interpreted as the class of shares that represents the majority of the voting power and value of the company. When no single class of shares represents the majority of the voting power and value of the company, the "principal class of shares" is generally those classes that in

the aggregate possess more than 50 percent of the voting power and value of the company. The term "shares" shall include depository receipts thereof or trust certificates thereof. In determining voting power, any shares or class of shares that are authorized but not issued shall not be counted; and, in mutual agreement between the competent authorities, appropriate weight shall be given to any restrictions or limitations on voting rights of, or entitlement to disproportionately higher participation in, issued shares.

Subparagraph 1(f) grants benefits to a company of which no more than five publicly-traded companies, as defined in subparagraph 1(e), own, directly or indirectly, at least 90 percent of their shares. Such ownership must be at least 90% by vote and value. Each person in the ownership chain must be a resident of a Contracting State and the owner of any remaining portion of the company must be an individual resident of a Contracting State. This would allow a corporation to qualify for benefits if, for example, it is a wholly-owned subsidiary of a publicly-traded company that satisfies the tests of subparagraph 1(e) and would, therefore, itself qualify for benefits if it received any income from the other Contracting State. If the ownership of any remaining portion of the company belongs to more than one individual, each such individual must be a resident of a Contracting State. Therefore, up to 10% of shares are permitted to be held by individual residents of a Contracting State.

Subparagraph 1(g) provides that a not-for-profit organization that is a resident of a Contracting State is entitled to benefits from the other Contracting State if it satisfies two conditions: (1) It must be generally exempt from tax in its State of residence by virtue of its not-for-profit status, and (2) more than half of the beneficiaries, members, or participants, if any, in the organization must be persons entitled, under this Article, to the benefits of the Convention.

Subparagraph 1(h) grants benefits to a resident of a Contracting State if that person is a recognized headquarters company for a multinational corporate group. A person is considered a headquarters company for this purpose only if several conditions, specified in the Memorandum of Understanding, are satisfied: The person seeking such treatment must perform in its residence State a substantial portion of the overall supervision and administration of the group, which may include, but cannot be principally, group financing; the person must have, and exercise, independent discretionary authority to carry out these functions; and it must be subject to the same income taxation rules in its residence State as are persons engaged in the active conduct of a trade or business, as described above in connection with the active business test under subparagraph 1(c).

In addition, the headquarters company must meet the following conditions: Either for the taxable year concerned, or as an average for the preceding four years, the activities and gross income of the corporate group that the headquarters company supervises and administers must be spread sufficiently among several countries. The group must consist of corporations resident in, and engaged in an active business in, at least five countries or groups of countries, and the income derived in the Contracting State of which the headquarters company is not a resident must be derived in connection with, or to be incidental to, that active business. The business activities carried on in each of the five countries or groupings of countries must generate at least 10 percent of the gross income of the group. The business activities carried on in any one country other than the Contracting State where the headquarters company resides may not generate 50 percent or more of the gross income of the group. Moreover, no more than 25 percent of the headquarters company's gross income may be derived from the other Contracting State. These tests also appear in the U.S.-France treaty.

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

Paragraph 2 provides that a resident of a Contracting State that does not qualify for benefits of the Convention under the provisions of paragraphs 1 and 4, nevertheless, may be granted benefits at the discretion of the competent authority of the Contracting State in which the income arises. The competent authority of the State requested to give benefits will consult with the competent authority of the other State before denying benefits under this paragraph.

The Memorandum of Understanding provides some discussion and guidance as to how the discretionary authority is to be exercised. Relevant portions are reproduced below.

It is assumed that, for purposes of implementing paragraph 2, a taxpayer will be permitted to present his case to his competent authority for an advance determination based on the facts, and will not be required to wait until the tax authorities of one of the Contracting States have determined that benefits are denied before making a request under this paragraph. In these circumstances, it is also expected that if the competent authority determines that benefits are to be allowed, they will be allowed retroactively to the time of entry into force of the relevant treaty provision or the establishment of the structure

in question, whichever is later.

In making determinations under paragraph 2, it is understood that the competent authorities will take into account all relevant facts and circumstances. The factual criteria the competent authorities are expected to take into account include the existence of a clear business purpose for the structure and location of the income earning entity in question; the conduct of an active trade or business (as opposed to a mere investment activity) by such entity; a valid business nexus between that entity and the activity giving rise to the income and the extent to which the entity, if it is a corporation, would be entitled to treaty benefits comparable to those afforded by the Convention if it had been incorporated in the country of residence of the majority shareholders.

The following example illustrates the application of these principles:

Facts: Austrian, German and Belgian companies, each of which is engaged directly or through its affiliates in substantial active business operations in its country of residence, decide to cooperate in the development, production and marketing of an advanced passenger aircraft through a corporate joint venture with its statutory seat in Austria. The development, production and marketing aspects of the project are carried out by the individual joint venturers. The joint venture company, which is staffed with a significant number of managerial and financial personnel seconded by the joint venturers, acts as the general headquarters for the joint venture, responsible for the overall management of the project including coordination of the functions separately performed by the individual joint venturers on behalf of the joint venture company, the investment of working capital contributed by the joint venturers and the financing of the project's additional capital requirements through public and private borrowings. The joint venture company derives portfolio investment income from U.S. sources. Is this income eligible for benefits under the U.S.-Austrian treaty?

Analysis: If the joint venture corporations's activities constitute an active business and the income is connected to that business, benefits would be allowed under subparagraph 1(c). If not, it is expected that the U.S. competent authority would determine that treaty benefits should be allowed

in accordance with paragraph 2 under the facts presented, particularly in view of (i) the clear business purpose for the formation and location of the joint venture company; and (ii) the significant headquarters functions performed by that company in addition to financial functions.

The fact that all of the joint venturers are corporations resident in European Union member States having tax treaties in force with the United States and that they are engaged directly or through their affiliates in substantial active business operations in such EU member states is an element in determining eligibility for benefits under paragraph 2.

The discretionary authority granted to the competent authorities in paragraph 2 is particularly important in view of the developments in, and objectives of, international economic integration, such as that among the member states of the European Union and the members of the North American Free Trade Agreement. It is expected that the authority will be exercised with particular cognizance of those factors.

The Memorandum of Understanding notes that the United States and Austria will discuss whether Article 16 should be amended to reflect Austria's relationship with its EU partners. If such an amendment proves to be desirable, a Protocol to the Convention will be promptly negotiated to reflect this understanding.

Paragraph 4 addresses the so-called "triangular case," in which an Austrian enterprise derives interest or royalty income from the United States, and that income is attributable to a permanent establishment located in a third jurisdiction, and that third jurisdiction imposes little or no income tax liability on those profits. This provision is necessary in this Convention to prevent triangular case abuse since Austria exempts from tax profits attributable to a permanent establishment of its residents located in certain countries, although it would tax the income (subject to a foreign tax credit) if the income were earned directly by the Austrian resident and were not attributable to the permanent establishment in the third jurisdiction. The Contracting States agreed that it would be inappropriate to grant treaty benefits with respect to such income. Therefore, paragraph 4 generally denies any treaty benefit with respect to interest or royalty income beneficially owned by an Austrian resident and attributable to a permanent establishment in a third jurisdiction if the combined tax in Austria and the third jurisdiction is less than 60 percent of the tax that would be imposed in Austria if the income were subject to tax there. The paragraph is drafted for Austria only since it has no application with respect to the United States, because the United States does not exempt the profits of a U.S. company attributable to its

foreign permanent establishments.

For example, assume that an Austrian Company has a permanent establishment in a third country and that the permanent establishment earns royalty income derived in the United States. The royalty income is attributable to the permanent establishment of the Austrian company in the third country. Also assume that, under the tax treaty in force between Austria and the third country, Austria will not impose its income tax on the profits of the Austrian company from its permanent establishment in the third country. Assume further that the royalty income received by the Austrian company will be subject to income tax in the third country at an effective rate of 22% (using a tax base comparable to that used in Austria). Inasmuch as 22% taxation in the third country exceeds 60% of the tax that Austria would have imposed (34%), the special disqualification provision of paragraph 4 does not apply to that income.

The paragraph provides three exceptions to the general restrictions. First, the provisions of paragraph 4 do not apply to interest derived in connection with or incidental to an active trade or business carried on by the permanent establishment in the third jurisdiction. The business of making or managing investments is not an active trade or business for this purpose unless the activities are banking or insurance activities carried on by a bank or insurance company. Second, they do not apply to royalties received as compensation for the use of, or the right to use, intangible property produced or developed by the permanent establishment itself. Third, in the case of an Austrian resident with a permanent establishment in a third jurisdiction, the provisions of paragraph 4 do not apply if the profits of the permanent establishment are taxed in the United States, i.e., under the subpart F provisions of Part III of Subchapter N of chapter 1 of subtitle A of the Internal Revenue Code.

Paragraph 5 provides additional authority to the competent authorities (in addition to that of Article 25 (Mutual Agreement Procedure)) to consult together to develop a common application of the provisions of this Article. This provision is intended to expedite matters relating to the factors relevant in making a determination regarding qualification for treaty benefits.

Article 17. ARTISTES AND ATHLETES

This Article deals with the taxation by 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 term is considered to include participants in certain activities, such as chess and bridge tournaments, who might not be considered "athletes" in the

traditional sense. The Article applies both to the income of an entertainer or athlete who performs services on his own behalf and one who performs services on behalf of another person, either as an employee of that person, or pursuant to any other arrangement. Paragraph 1 of the Article applies only with respect to the income of performing artists and athletes, themselves. Paragraph 2 applies in certain circumstances to income received by persons providing the services of the 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 (Independent Personal Services) and 15 (Dependent Personal Services).

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, the other Contracting State may tax the income derived by a resident of a Contracting State from personal activities as an entertainer or athlete exercised in the other Contracting State if the amount of the gross receipts derived by the individual exceeds $20,000 (or its equivalent in Austrian shillings) for the taxable year. The $20,000 includes expenses reimbursed to or borne on behalf of, the individual. 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 or athletes with no dollar or time threshold. The United States imposes a dollar-threshold test in its treaties to distinguish between two groups of entertainers and athletes -- those who are paid very large sums of money for very short periods of service, and who would, therefore, normally be exempt from host country tax under the standard personal services income rules, and those who earn 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) and 15 (Dependent Personal Services). Thus, an individual who would otherwise be exempt from tax under those Articles, but is subject to tax under this Article, may be taxed. An entertainer or athlete who receives less than the $20,000 threshold amount, and who is, therefore, not subject to host-country tax under this Article may, nevertheless, be subject to tax in that country under Article 7, 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 taxable year, but the income is attributable to a fixed base regularly available to the entertainer in the State of performance, that State may tax that income under Article 14.

Since it is frequently not possible to know until the end of the year whether the income an entertainer or athlete derived from performance in a Contracting State exceeds $20,000, nothing in the Convention precludes that Contracting State from withholding tax during the year and refunding after the close of the year if the taxability threshold is then shown to have not been met. (See discussion of paragraph 3, below, regarding withholding of tax on payments to a person other than the performer.)

Article 17 applies to all income directly connected with a performance by the entertainer, such as appearance fees, award or prize money, and a share of the gate receipts. Income derived from a Contracting State from other than actual performance, such as royalties from record sales and payments for product endorsements, is not covered by this Article, but by other articles of the Convention, such as Article 12 (Royalties) or Article 14 (Independent Personal Services). For example, if an entertainer receives royalty income from the sale of live recordings, the royalty income would be exempt from source country tax under Article 12, even if the performance was conducted in the source country, although he could be taxed in the source country with respect to income from the performance itself under this Article if the dollar threshold is exceeded.

In determining whether income falls under Article 17 or another article, the controlling factor will be whether the income in question is predominantly attributable to the performance itself or other activities or property rights. For instance, a fee paid to a performer for endorsement of a performance in which the performer will participate would be considered to be so closely associated with the performance itself that it normally would fall within Article 17. Similarly, a sponsorship fee paid by a business in return for the right to attach its name to the performance would be so closely associated with the performance that it would fall under Article 17 as well. A cancellation fee would not be considered to fall within Article 17 but would be other income within the meaning of Article 21 (Other Income). Each case must be evaluated based on its individual facts and circumstances.

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

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 but, instead, accrues 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, for example, be a company established and owned by the performer, which is merely acting as the nominal income recipient in respect of the remuneration for the entertainer's performance. The entertainer may be acting as an "employee" receiving a modest salary and arranging to receive the remainder of the income from the performance in another form or at a later time. In such case, absent the provisions of paragraph 2, the company providing the entertainer's services can escape host State tax because it earns business profits but has no permanent establishment in that State. The income could later be paid out to the entertainer at a time when the entertainer 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 allowing the benefits of the Convention when a legitimate employee-employer relationship exists between the performer and the person providing services. Under paragraph 2, when the income accrues to a person other than the performer, resident in the same Contracting State as the performer, and the performer (or persons related to him or her) 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. If the "employer" is resident in a third State, this Convention does not apply to its income. It is, therefore, subject to the host country's internal law, or to the provisions of a treaty if one exists, between the host country and the country of residence of the "employer."

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, participates directly or indirectly in the profits of the person providing the services of the entertainer or athlete. Consider for example, a circus owned by a U.S. corporation that performs in Vienna and the Austrian promoters of the performance pay the circus, which, in turn, pays salaries to the clowns. The circus has no permanent establishment in Austria. Since the clowns do not participate in the profits of the circus, but merely receive their salaries from the circus' gross receipts, the circus is protected by Article 7 and its income is not subject to Austrian tax. Whether the salaries of the clowns are subject to Austrian tax depends on whether the salaries exceed the $20,000 threshold. This exception for non-abusive cases is not in the OECD Model, but reflects the U.S. position that the purpose of the paragraph is to prevent abuse of the provisions of Articles 7 and 14 in this context.

Paragraph 3 authorizes the Contracting State where a performer's activities are exercised to withhold tax on payments made to a person other than the entertainer or athlete for activities exercised by the entertainer or athlete in cases where paragraph 2 does not apply. Whereas paragraph 2 covers abusive cases, this paragraph is needed where there is no abuse, but payment is made to an agent of the entertainer or athlete. This language conforms to U.S. policy. Upon request of the person to whom the payment is made, the amount withheld in excess of the tax liability of the entertainer or athlete shall be refunded. Refund claims must be accompanied by the necessary documentation. For example, the Austrian organizer of a domestic public performance enters into a contract with a U.S. artiste promotion agency. Under that contract the U.S. agency agrees to send a U.S. entertainer (who has no contractual arrangements with the Austrian organizer but only with the promotion agency) to perform in Austria. The Austrian organizer has to pay 1,000,000 to the agency which in turn has to pay a contractual fee of 600,000 to the artiste. Under paragraph 3, Austria is entitled to withhold 20% of the 1,000,000 paid to the agency and the agency in turn is entitled to claim a refund of 20% of 400,000 (provided it can prove that only 600,000 was paid to the artiste). However, if paragraph 2 applies, no tax refund would take place.

The Memorandum of Understanding provides the following clarification of the treatment of orchestras and their members:

> Paragraph 1 of Article 17 relates only to individuals. Legal entities operating an orchestra (like associations, municipalities, and states) are, according to paragraph 1, not taxable in the country where such orchestra performs, although such entities may be subject to tax in the country of performance under paragraph 2 of this Article or under Article 7 (Business Profits). The individual musicians would be taxable there, but only if their annual remuneration received for the performance in the host state exceeded the threshold of 20,000 U.S. dollars. In the case of a monthly paid salary only that portion of the monthly pay may become taxable which is allocable to the days physically spent in the host country. If, however, a performance-related global payment is made, then the whole amount shall be taken into consideration without any deduction for periods of preparation spent outside the host State.

The reference in the Memorandum of Understanding to a performance-related global payment refers to a payment consisting of compensation for performance and preparation where each such activity is not separately compensated under the artiste's or athlete's contract. Therefore, where a payment is for a performance in a host State, including preparation done outside the host State, the whole amount may be taken into account by the host State with no deduction for periods of preparation spent outside the host State.

The 1956 Convention contains no special rules for the taxation of the income of entertainers and athletes. Such income was subject to the general rules for the taxation of personal service income, which imposed, among others, a $3,000 threshold for taxation of personal services income.

This Article is subject to the provisions of the saving clause of paragraph 4 of Article 1 (Personal Scope). Thus, if an entertainer or athlete who is resident in Austria is also a citizen of the United States, the United States may tax all of his or her income from performances in the United States without regard to the provisions of this Article, subject, however, to the special foreign tax credit provisions for U.S. citizens who are residents of Austria found in paragraph 2 of Article 22 (Relief from Double Taxation). In addition, benefits of this Article are subject to the provisions of Article 16 (Limitation on Benefits).

Article 18. PENSIONS

This Article deals with the taxation of private pensions and annuities, social security benefits, alimony payments and child support payments, and with the tax treatment of cross-border contributions to pension plans.

Subparagraph 1(a) provides that, except where the provisions of Article 19 (Government Service) apply (i.e., where a pension is paid in respect of Government service), pensions and other similar remuneration derived and beneficially owned by a resident of a Contracting State in consideration of past employment are taxable only in the State of residence of the recipient. This rule applies to both periodic and lump-sum payments. The term "pensions and other similar remuneration" includes amounts paid by all private retirement plans and arrangements in consideration of past employment, regardless of whether they are qualified plans under U.S. law, including plans and arrangements described in section 457 or 414(d) of the Internal Revenue Code. It also includes an Individual Retirement Account. Treatment of such pensions under the 1956 Convention is essentially the same as under this Convention.

Subparagraph 1(b) provides that social security payments and other public pensions paid by one of the Contracting States to a resident of the other Contracting State or to a United States citizen are taxable only in the paying State. The reference to U.S. citizens is to ensure that a social security payment by Austria to a U.S. citizen not resident in the United States will not be taxable by the United States. The fact that these provisions are also subject to the provisions of Article 19 places the treatment of social security benefits paid in respect of past government service under the rules of that article rather than this one.

The Memorandum of Understanding clarifies that the term "social security payments" is not restricted to old age pensions but refers to all sorts of social security benefits, e.g., to benefits granted in kind and to payments made in compensation for work-related diseases or accidents. The term "other public pensions" as used in subparagraph 1(b) is intended to refer to tier 1 Railroad Retirement benefits.

Paragraph 2 provides that annuities 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). Annuities are similarly treated under the 1956 Convention.

Paragraphs 3 and 4 deal with alimony and child support

payments. Under paragraph 3, alimony paid by a resident of a Contracting State is taxable only in that State. The payment need not be taxable to the recipient under internal law of the recipient's State of residence to qualify as an alimony payment. Paragraph 4 deals with periodic payments that are not dealt with in paragraph 3. Under this paragraph, such payments for the support of a minor child by a resident of a Contracting State to a resident of the other Contracting State are exempt from tax in both Contracting States.

Alimony and child support payments are defined as periodic payments made pursuant to a written separation agreement or a decree of divorce, separate maintenance, or compulsory support.

Under U.S. law, alimony generally is deductible to the payor and taxable in the hands of the recipient, and child support payments are neither deductible nor included as income to the recipient. Under Austrian law, both alimony and child support payments are treated as non-deductible and non-includible payments.

Paragraph 5 deals with the taxation of contributions, borne by an individual who renders dependent personal services in a Contracting State (the "host State"), to a pension scheme established in, and recognized for tax purposes in, the other Contracting State. In general, when determining the individual's taxable income, the host State shall treat such contributions in the same way and subject them to the same conditions and limitations as contributions made to a pension scheme in that host State. However, such treatment is provided only if (i) the individual was not a resident of the host State and was contributing to the pension scheme immediately before beginning to work in that State and (ii) the competent authority of the host State agrees that the pension scheme in the other State generally corresponds to a pension scheme recognized as such for tax purposes by the host State. A pension scheme means an arrangement in which the individual participates to receive retirement benefits in respect of dependent personal services rendered. A pension scheme is recognized for tax purposes in a State if contributions to the scheme would qualify for tax relief in that State. Paragraph 5 permits a deduction from the individual's income for qualifying amounts borne by the individual, whether the payment is made by the individual or by another person on behalf of the individual.

Subparagraph 1(b) and paragraph 3 of this Article are among the exceptions to the saving clause of paragraph 4 of Article 1 (Personal Scope) found in subparagraph 5(a) of that Article. Thus, Austrian social security benefits paid to a U.S. resident or citizen are exempt from U.S. taxation. Similarly, an alimony payment by an Austrian resident to a resident or citizen of the

United States is taxable only in Austria. The provisions of this Article dealing with pensions, annuities and child support payments are, however, subject to the saving clause of paragraph 4 of Article 1. Such payments received by a resident or citizen of the United States may, therefore, be subject to U.S. tax, if they are so subject under the Code, even if they would be exempt under the provisions of this Article.

Article 19. GOVERNMENT SERVICE

This Article deals with the taxation of compensation paid by a government in respect of government service performed in the discharge of governmental functions and paid from public funds.

Paragraph 1 provides that, as a general rule, wages, salaries and similar remuneration including pensions, annuities or similar benefits, paid from public funds of a Contracting State, or one of its political subdivisions or local authorities, to a citizen of that State who is an employee of the paying entity for services rendered in the discharge of governmental functions to that State, subdivision, or local authority shall be taxable only in that State. The Memorandum of Understanding clarifies that if a governmental entity, such as an Embassy or Consulate, is performing governmental functions, all of its employees, including persons such as cooks or drivers, are to be considered as employed in the discharge of governmental functions. Social security benefits paid in respect of government services are dealt with in this Article, not Article 18 (Pensions).

Paragraph 2 specifies that remuneration and pensions paid in respect of services performed in connection with a business carried on by a Contracting State or a political subdivision or local authority thereof are not subject to the provisions of paragraph 1, but are taxable under the provisions of Articles 14 (Independent Personal Services), 15 (Dependent Personal Services), 17 (Artistes and Athletes), and 18 (Pensions). Thus, if a local government sponsors a basketball team in an international tournament, and pays the athletes from public funds, the compensation of the players is covered by Article 17 and not Article 19, because the athletes are not engaging in a governmental function when they play basketball.

Paragraph 3 provides that paragraph 1 shall also apply, generally, to remuneration paid to the Austrian Foreign Trade Representatives of the Austrian Federal Economic Chamber and to the staff members of the Austrian Foreign Trade Offices. The provision applies only to the extent that they are discharging governmental functions in the United States and that the recipients of such remuneration are Austrian citizens.

Pursuant to paragraph 5(b) of Article 1 (Personal Scope), the benefits of this Article are not subject to the saving clause of paragraph 4 of Article 1, with respect to individuals who are neither citizens of, nor lawful permanent residents in, that State. Thus, for example, an individual who is a U.S. citizen or a lawful permanent resident of the United States and who is employed by the Government of Austria in the United States, would, notwithstanding this Article, be fully subject to U.S. tax.

Article 20. STUDENTS AND TRAINEES

This Article provides that a resident of one of the Contracting States who goes to the other Contracting State for the purpose of full-time education at a recognized educational institution or for full-time training shall be exempt from tax by that other Contracting State with respect to payments that arise outside that State and that are for the purpose of the individual's maintenance, education, or training. The tax exemption, however, applies to an apprentice or business trainee for a maximum of three years from the day the apprentice or trainee first arrives in the State for the purpose of the apprenticeship or business training.

If the visitor comes principally to work in the host State but also is a part-time student, he would not be entitled to the benefits of this Article, even with respect to any payments he may receive from abroad for his maintenance or education, and regardless of whether or not he is in a degree program. Whether a student is to be considered full-time will be determined by the rules of the educational institution at which he is studying. Similarly, a person who visits the host State for the purpose of obtaining business training and who also receives a salary from his employer for providing services would not be considered a trainee and would not be entitled to the benefits of this Article.

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

A payment will be considered to arise outside the host State if the payor is located outside the host State. Thus, if an employer from one of the Contracting States sends an employee to the other Contracting State for training, the payments the trainee receives from abroad from his employer for his mainte-

nance or training while he is present in the host State will be exempt from host-country tax.

The 1956 Convention provides a similar exemption for students, but does not require full-time attendance at a recognized educational institution. As under this Convention, the 1956 Convention does not impose a time limit on the length of stay for purposes of the tax exemption. For apprentices, the 1956 Convention provides a broad exemption from host country tax for persons temporarily present, without a specific time limitation, for purposes of acquiring business or technical experience. The 1956 Convention also provides an exemption from host country tax for the compensation for services of certain trainees whose annual compensation for services performed does not exceed $10,000.

By virtue of the exceptions to the saving clause in subparagraph 5(b) of Article 1 (Personal Scope), the benefits conferred by the host State are not subject to the saving clause of paragraph 4 of Article 1 with respect to individuals who are neither citizens of nor lawful permanent residents in that State. Thus, a citizen of the United States who is a resident of Austria and is in the United States to study at an American university does not benefit from the U.S. tax exemption accorded by this Article. However, if the individual is not a citizen of the United States and does not acquire immigrant status in the United States, the fact that the individual may become a U.S. resident for tax purposes will not lead to a denial of the benefits of this Article.

Article 21. OTHER INCOME

This Article provides the rules for the taxation of items of income that are not dealt with in the other articles of the Convention. The Article assigns taxing jurisdiction over such items of income generally to the State of residence of the beneficial owner of the income. Items of income covered by this Article include classes of income not dealt with elsewhere in the Convention, such as, for example, gambling winnings. It also includes items of income that are not dealt with in the other articles because the income in question does not meet certain characteristics of the income covered by the other articles. For example, Article 10 (Dividends) deals with dividends paid by a company that is a resident of a Contracting State. A dividend paid by a third-country corporation would not be covered by Article 10, and would, therefore, come within the scope of this Article.

The general rule of paragraph 1 that the "other income" of a resident of a Contracting State will be taxable only in the State of residence applies irrespective of whether the residence State

exercises its right to tax the income covered by the Article.

Paragraph 2 contains an exception to the general rule of paragraph 1 for income, other than income from real property, that is effectively connected with a permanent establishment or fixed base maintained in a Contracting State by a resident of the other Contracting State. The taxation of such income is governed by the provisions of Articles 7 (Business Profits) and 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 Austria would be taxable by the United States.

An exception to this rule in paragraph 2 is provided for income from real property, as defined in paragraph 2 of Article 6 (Income from Real Property). 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 income from the property if neither the situs of the property nor the residence of the owner is in that State. For example, if an Austrian resident derives income from real property located outside the United States that is effectively connected with the resident's permanent establishment or fixed base in the United States, only Austria may tax that income. This special rule for foreign-situs real property is consistent with the general rule, also reflected in Article 6, that only the situs and residence States may tax real property and real property income.

This Article is subject to the saving clause of paragraph 4 of Article 1 (Personal Scope). Thus, the United States may tax the income of an Austrian resident not dealt with elsewhere in the Convention, if that Austrian resident is a citizen of the United States. The benefits of this Article are also subject to the provisions of Article 16 (Limitation on Benefits), which require that the beneficial owner of the income is qualified to receive treaty benefits under at least one of the tests of Article 16.

Article 22. RELIEF FROM DOUBLE TAXATION

Article 22 describes the manner in which each Contracting State undertakes to relieve double taxation. The United States uses the foreign tax credit method. Austria uses a foreign tax credit method as laid down in Article 23 B of the OECD Model Convention.

In paragraph 1, the United States agrees to allow its citizens and residents to credit against their U.S. income tax the income taxes paid to Austria. Paragraph 1 also provides for a deemed-paid credit, consistent with section 902 of the Code, to

a U.S. corporation in respect of dividends received from an Austrian corporation in which the U.S. corporation owns at least 10 percent of the voting shares. This credit is for the tax paid by the Austrian corporation on the earnings out of which the dividends are considered paid.

The credit under the Convention is allowed in accordance with the provisions and subject to the limitations of U.S. law, as that law may be amended overtime, so long as the general principle of this Article, i.e., the allowance of a credit, is retained. Thus, although the Convention provides for a foreign tax credit, the terms of the credit are determined by the Provisions, at the time a credit is given, of the U.S. statutory credit, U.S. law generally limits the credit against U.S. tax 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 on some variation thereof. Paragraph 4 specifies the rules for determining the source of income for credit purposes under the Convention.

Paragraph 1 also provides that the Austrian income taxes specified in paragraphs 2(b) and 3 of Article 2 (Taxes Covered) are to be treated as income taxes for purposes of allowing a credit under the Convention. It is not U.S. policy to allow credit by treaty for taxes that are not creditable under the Code, and it was the understanding of the negotiators that the Austrian income taxes specified in Article 2 for which credit is allowed under Article 22 are creditable taxes under the Code.

The Memorandum of Understanding clarifies that the relevant laws for purposes of the U.S. foreign tax credit granted in paragraph 1 are the laws as of the date of entry into force of the treaty, as they may be subsequently amended. Under U.S. law, when the Alternative Minimum Tax (AMT) is due, foreign tax credits may reduce the AMT, but not to zero, as such credits can offset only 90 percent of the AMT. The Memorandum of Understanding notes that this limitation is consistent with the general U.S. commitment to provide a foreign tax credit.

The Memorandum of Understanding also illustrates how to calculate the dividend gross-up and the deemed-paid credit. The deemed-paid credit is calculated as the ratio of dividends received to after-tax foreign earnings multiplied by creditable foreign taxes. The U.S. parent must include in income the actual dividend received plus the "gross up" for foreign taxes deemed paid. The total foreign tax credit allowed, subject to the foreign tax credit limitation, equals the sum of actual withholding taxes paid plus the deemed-paid credit.

Paragraph 2 sets out the rules for taxing U.S. citizens who are residents of Austria. Since U.S. citizens are subject to U.S. tax at ordinary progressive rates on their worldwide income, the U.S. tax on the U.S. source income of a U.S. citizen resident in Austria will often exceed the U.S. tax allowable under the Convention on an item of U.S. source income derived by a resident of Austria who is not a U.S. citizen.

Subparagraph 2(a) provides special Austrian credit rules for certain items of income received by Austrian residents who are U.S. citizens. For income that is either exempt from U.S. tax or subject to a reduced rate of tax under the Convention when derived by Austrian residents who are not U.S. citizens, Austria shall allow a foreign tax credit to its residents who are U.S. citizens only for the tax that the United States may impose under the provisions of the Convention, other than the taxes that it may impose only by reason of U.S. citizenship of the taxpayer under the saving clause of paragraph 4 of Article 1 (Personal Scope). Thus, if a U.S. citizen resident in Austria receives U.S. source portfolio dividends, the foreign tax credit granted by Austria would be limited to 15 percent of the dividend -- the U.S. tax that may be imposed under subparagraph 2(b) of Article 10 (Dividends) -- even if the shareholder is subject to U.S. net income tax because of his U.S. citizenship. With respect to royalty (other than motion picture royalties) or interest income, Austria would allow no foreign tax credit, because its residents are exempt from U.S. tax on these classes of income under the provisions of Articles 11 (Interest) and 12 (Royalties).

Subparagraph 2(b) deals with the potential for double taxation which can arise as a result of the absence, because of subparagraph 2(a), of a full Austrian foreign tax credit for the U.S. tax imposed on its citizens resident in Austria. The subparagraph provides that the United States will credit the Austrian income tax paid after allowance of the credit provided for in subparagraph 2(a). It further provides that in allowing the credit, the United States will not reduce its tax below the amount allowed as a creditable tax in Austria under subparagraph 2(a). Since the income dealt with in this paragraph is U.S. source income, it is necessary to resource some of the income in respect of which the United States is required to allow a credit under subparagraph 2(b) as Austrian source in order for the United States to be able to credit the Austrian tax effectively. Subparagraph 2(c) provides for this resourcing. It deems the items of income referred to in subparagraph 2(a) to be from Austrian sources to the extent necessary to avoid double taxation under subparagraph 2(b). This resourcing is for the exclusive purpose of relieving double taxation in the United States with respect to certain U.S. source income of its citizens who are resident in Austria. This provision is not affected by the general foreign tax credit source rules in paragraph 4.

Paragraph 3 describes how Austria will avoid double taxation under the Convention. Subparagraph 3(a) provides that Austria will allow a resident of Austria who derives income that may be taxed in the United States (unless the U.S. right to tax is solely by virtue of citizenship under the saving clause of paragraph 4 of Article 1 (Personal Scope)), to deduct from Austrian tax (i.e., to credit) an amount equal to the tax paid on that income in the United States. The credit, however, may not exceed that part of the Austrian income tax (computed before the credit) that is attributable to the income that the United States may tax. The branch tax levied under paragraph 6 of Article 10 (Dividends) shall be attributable to the income of the permanent establishment in the year in which the tax is levied.

Subparagraph 3(b) allows Austria to take into account any income that is exempt from tax under this Convention when computing the amount of Austrian tax due on the remaining income of the resident (i.e., Austria may apply exemption with progression).

Paragraph 4 sets forth the rules for determining the source of income and profits for purposes of double tax relief under the Convention. For determining the source of income for U.S. foreign tax credit purposes, the rules of this paragraph apply only for crediting the taxes referred to in paragraphs 2(b) and 3 of Article 2 (Taxes Covered). As a general rule, where under the treaty (other than by application of the saving clause of paragraph 4 of Article 1 (Personal Scope)) a Contracting State may tax a resident of the other Contracting State on an item of income, that income is deemed to be sourced in the first-mentioned State. Where income of a resident of a Contracting State may not be taxed in the other State, the income is deemed to be sourced in the State of residence of the income recipient. In general, such source rules provided in the Convention for purposes of determining the taxing rights of the Contracting States, are consistent with the Code source rules for foreign tax credit and other purposes. Where, however, the Convention and Code source rules are inconsistent, 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 2 of the Article provides an exception to this general rule with respect to certain U.S. source income of U.S. citizens resident in Austria, as discussed above.)

This Article is not subject to the saving clause of paragraph 4 of Article 1 (Personal Scope). Thus, the United States will allow a credit to its citizens and residents in accordance with the Article, even if such credit were to provide a benefit not available under U.S. law.

Article 23. NONDISCRIMINATION

This Article assures that nationals and residents of a Contracting State will not be subject to discriminatory taxation in the other Contracting State. It also provides for nondiscriminatory taxation of residents of the taxing State with respect to deductions for amounts paid to residents of the other State. It also prohibits a State from imposing discriminatory taxation upon its resident companies that are owned, partly or wholly, by residents of the other State. Non-discrimination, in the context of this Article, means providing national treatment.

Paragraph 1 provides that a national of one Contracting State may not be subject to taxation or connected requirements in the other Contracting State which are other or more burdensome than the taxes 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 Austria as an Austrian national who is in similar circumstances (i.e., who is also resident in the third country). The term "national" is defined in subparagraph 1(h) of Article 3 (General Definitions).

The United States is not obligated, by virtue of paragraph 1, to apply the same taxing regime to an Austrian national who is not resident in the United States and a U.S. national who is not resident in the United States since that paragraph applies only when the nationals of the two Contracting States are in the same circumstances. United States citizens who are not residents of the United States but who are, nevertheless, subject to United States tax on their worldwide income are not in the same circumstances with respect to United States taxation as citizens of Austria who are not United States residents. Thus, for example, Article 23 would not entitle an Austrian national not resident in the United States to the net basis taxation of U.S. source dividends or other investment income that applies to a U.S. citizen not resident in the United States.

Paragraph 2 provides that a permanent establishment in a Contracting State of an enterprise of the other Contracting State may not be less favorably taxed in the first-mentioned than an enterprise of that first-mentioned State which is carrying on the same activities. This provision, however, does not obligate a Contracting State to grant to a resident of the other Contracting State any tax allowances, reliefs, etc., which it grants to its own residents on account of their civil status or family responsibilities. Thus, if an individual resident in Austria owns an Austrian 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 Austrian 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 an Austrian 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. The Memorandum of Understanding makes clear, 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 Austrian partnerships, since the law requires that partnerships of both domiciles withhold tax in respect of the partnership shares of non-U.S. partners. In distinguishing between U.S. and Austrian partners, the requirement to withhold on the Austrian but not the U.S. partner's share is not discriminatory taxation; rather, like other withholding on nonresident aliens, is merely a reasonable method for the collection of tax from persons who are not continually present in the United States, and as to whom it 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 overwithholding, file a U.S. tax return claiming a refund.

The Memorandum of Understanding also notes that paragraph 2 requires Austria to grant to an Austrian permanent establishment of a U.S. corporation the same carry-forward of losses that would be allowed to a permanent establishment of an Austrian corporation.

Paragraph 3 prohibits discrimination in the allowance of deductions. When an enterprise of a Contracting State pays interest, royalties or other disbursements to a resident of the other Contracting State, the first 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 Contracting State. An exception to this rule is provided for cases where the provisions of paragraph 1 of Article 9 (Associated Enterprises), paragraph 4 of Article 11 (Interest) or paragraph 5 of Article 12 (Royalties) apply, because all of these provisions permit deductions to be denied in certain circumstances in respect of transactions between related persons. This exception would include the denial or deferral of certain interest deductions under Code section 163(j). The term "other disbursements" is understood to include a reasonable allocation of executive and general administrative

expenses, research and development expenses and other expenses incurred for the benefit of a group of related persons which includes the person incurring the expense.

Paragraph 3 also provides that any debts of an enterprise of a Contracting State to a resident of the other Contracting State are deductible in the first Contracting State in computing the capital tax of the enterprise under the same conditions as if the debt had been contracted to a resident of the first-mentioned Contracting State. Even though a Contracting State may not now impose a national tax on capital, because the nondiscrimination provisions apply to all taxes levied at all levels of government in the U.S. and Austria, this provision may be relevant for U.S. as well as Austrian tax purposes, because of taxes on capital, such as real property taxes, levied by sub-national governments.

Paragraph 4 prohibits a Contracting State from subjecting an enterprise of that State that is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State to taxation or connected requirements that are other or more burdensome than the taxation or connected requirements imposed on other similar enterprises in the first State.

As in the case of its other treaties, the United States takes the position, confirmed in the Memorandum of Understanding, that the provisions of Code section 367(e)(2) regarding the taxation of corporations on certain distributions in liquidation to foreign parent corporations are not contrary to paragraph 4 of the Article. It takes the same position with respect to its rules providing that a corporation with nonresident alien shareholders is not eligible to make an election to be an "S" corporation. In both cases, this position is based on the fact that corporations eligible for these benefits are not similarly situated. In the first case, a foreign parent corporation will not be subject to U.S. tax on a subsequent alienation, as would a U.S. corporation. In the second case, a foreign shareholder is not subject to U.S. tax on worldwide income, as are U.S. resident shareholders.

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

Paragraph 5 specifies that no provision of the Article will prevent either Contracting State from imposing the branch tax described in paragraphs 6 and 7 of Article 10 (Dividends). Thus, even if the branch tax were judged to violate the provisions of paragraphs 2 or 4 of this Article, neither Contracting State would be constrained from imposing the tax.

As noted above, 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 4 of Article 1 (Personal Scope) does not apply to this Article, by virtue of the exceptions in subparagraph 5(a) of that Article. Thus, for example, a U.S. citizen who is resident in Austria may claim benefits in the United States under this Article. As with all benefits under this Convention, the granting of benefits under this Article is subject to the requirement that the beneficial owner of the income qualify for benefits under the provisions of Article 16 (Limitation on Benefits).

Article 24. MUTUAL AGREEMENT PROCEDURE

This Article provides for cooperation between the competent authorities of the Contracting States to resolve disputes which 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(e) of Article 3 (General Definitions).

Paragraph 1 provides that where a person considers that the actions of one or both Contracting States will result for him in taxation which is not in accordance with the Convention he may present his case to the competent authority of his State of residence or nationality. 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 judges the case to have merit but cannot reach a unilateral solution, it shall seek agreement with the competent authority of the other Contracting State so as to avoid taxation not in accordance with the Convention. If agreement is reached under this provision, it is to be implemented even if implementation is otherwise barred by the statute of limitations or by some other procedural limitation, such as a closing agreement. Because, under paragraph 2 of Article 1 (Personal 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 on the application or interpretation of the Convention. The paragraph includes a non-exhaustive list of examples of the matters about which the competent authorities may reach agreement. They may agree to the same attribution of income, deductions, credits or allowances between an enterprise in one Contracting State and its permanent establishment in the other State or between related persons. The competent authorities may also agree to settle a variety of conflicting applications of the Convention, including those regarding the characterization of items of income, the application of source rules to particular items of income, and to a common meaning of a term.

The paragraph also authorizes the competent authorities to consult for purposes of eliminating double taxation in cases not provided for in the Convention. This provision is intended to permit the competent authorities to implement the Convention in particular cases in a manner that is consistent with its expressed general purposes, even though the cases are not, specifically covered by the Convention. An example of such a case might be double taxation arising from a transfer pricing adjustment between two permanent establishments of a third-country resident, one in the United States and one in Austria. Since no resident of a Contracting State is involved in the case (both permanent establishments being residents of the third State), the Convention does not, by its terms, apply, but the competent authorities may, nevertheless, use the authority of the Convention to seek to prevent the double taxation.

Paragraph 4 provides that the competent authorities may communicate with each other directly for the purpose of reaching agreement under this Article.

Paragraph 5 directs the competent authorities to consult with each other to develop an agreed application of the provisions of the Convention, including Article 16 (Limitation on Benefits). It also allows the competent authorities to prescribe regulations and carry out the purposes of the Convention.

The Memorandum of Understanding explains that the mutual agreement procedure is fully governed by the provisions of the treaty and of internal legislation and is not intended to create new treaty law. However, one of the main purposes of this provision is to find a coordinated understanding of treaty provisions that leaves room for divergent interpretations.

This Article is not subject to the saving clause of paragraph 4 Article 1 (Personal Scope), by virtue of the exceptions to the saving clause in subparagraph 5(a) of that Article. Thus, 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.

Article 25. EXCHANGE OF INFORMATION AND ADMINISTRATIVE ASSISTANCE

This Article provides for the exchange of information between the competent authorities of the Contracting States and for the provision of certain assistance in the collection of taxes.

Paragraphs 1 through 6 provide for the exchange of information. Paragraph 1 provides that 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 Austria concerning the taxes covered by this Article insofar as the taxation thereunder is not contrary to the Convention. Under paragraph 6 of this Article and paragraph 4 of Article 2, for purposes of the exchange of information provisions, the Convention applies to taxes of every kind imposed by a Contracting State. In applying the exchange of information provisions to all taxes imposed by a Contracting State, this provision conforms to Article 12 of the Estate and Gift Tax Treaty between the United States and Austria.

Paragraph 1 also clarifies that the carrying out of provisions of the domestic laws of the Contracting States concerning taxes includes penal investigations regarding fiscal offenses relating to taxes covered by this Article. This provision makes clear that information may be exchanged concerning penal, as well as non-penal tax investigations. A provision in the Memorandum of Understanding clarifies the meaning of the term "penal investigations" by applying the term to proceedings carried out by either judicial or administrative bodies and by providing an example of a penal investigation carried out by an administrative body. This example states that the commencement of a criminal investigation by the Criminal Investigation Division of the Internal Revenue Service constitutes a penal investigation. Therefore, the term "penal investigation" forms a basis for disclosure under Austrian bank secrecy laws and practices.

Another provision in the Memorandum of Understanding makes clear that information may be exchanged at any stage in a tax case, stating that a request for information cannot be rejected by the requested State merely because the request was made for the purposes of pending judicial proceedings in tax matters.

Paragraph 1 also provides that information may be exchanged spontaneously or on request and that the competent authorities may agree on information which shall be furnished on a regular basis. The purpose of these references to specific forms of exchange is to clarify, in addition to exchanging information upon specific request, that the exchange of information spontaneously by a Contracting State or, as mutually agreed, routinely between Contracting States is contemplated under the provisions of the Convention. No inference should be drawn that these references impose any restriction on the means that competent authorities may use to exchange information. Thus, for example, the exchange of information in connection with simultaneous examinations is contemplated. Also, on the basis of this Article, the presence of tax inspectors of a Contracting State on the territory of another Contracting State is allowed by both States, including, with the consent of the taxpayer, interviews with taxpayers. However, such direct contacts would have to be agreed upon by mutual agreement of the competent authorities and carried out by duly authorized representatives.

Paragraph 1 states that information exchange is not restricted by Article 1 (Personal 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 Austria which engages in transactions with a U.S. enterprise, the United States could request information with respect to that permanent establishment, even though it is not a resident of either Contracting State. Similarly, if a third-country resident maintains a bank account in Austria, the United States could request information with respect to that person's account to the same extent that it could request the information regarding a resident of Austria or the United States.

Paragraph 1 also provides assurances that any information exchanged will be treated as secret, subject to the same disclosure constraints as information obtained under the laws of the requesting State. Information received may be disclosed only to persons, including courts and administrative bodies, involved in the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, or the oversight of the administration of the taxes covered by this Article. The information may be used by these persons only in connection with these designated functions.

Under the Memorandum of Understanding, it is understood that persons involved in the oversight of the administration of taxes in the United States are the appropriate committees of the U.S. Congress as well as the U.S. General Accounting Office, where such access is necessary to carry out their oversight responsibilities. Information received by these bodies is for

use in the performance of their role in overseeing the administration of U.S. tax laws. It is also understood that persons involved in the oversight of the administration of taxes in Austria are the Accounting Court (Rechnungshof) and the committees of Parliament as is necessary to carry out their oversight responsibilities.

Paragraph 1 permits persons entitled to disclosure of information received to disclose it in public court proceedings or in judicial decisions.

It is contemplated that the Contracting States will utilize Article 25 to exchange information on a routine basis, on request in relation to a specific case, or spontaneously.

Paragraph 2 explains that the obligations undertaken in paragraph 1 to exchange information do not require a contracting State to carry out administrative measures which are at variance with the laws or administrative practice of either State. Nor does that paragraph require a Contracting State to supply information not obtainable under the laws or administrative practice of either State, or to disclose any trade, business, industrial, commercial or professional secret or trade process, or other information, the disclosure of which would be contrary to public policy.

Regarding subparagraph (b), due to the limitations under the internal law of Austria concerning bank secrecy, Austria will be able to obtain bank information only in connection with a penal investigation in the United States, as interpreted and agreed in the Memorandum of Understanding. Either Contracting State may, however, at its discretion, subject to the limitations of the paragraph and its internal law, provide information which it is not obligated to provide under the provisions of this paragraph.

Regarding subparagraph (c), the Memorandum of Understanding contains the agreement of the Contracting States that, on the basis of paragraph 19 of the *OECD Commentary* on Article 26 of the OECD Model Convention, the provisions on bankers discretion (bank secrecy rules) do not constitute a professional, trade, business, industrial, or commercial secret. In Austria, this opinion is supported by German and Austrian jurisprudence. (The German language has one term referring to both "trade" and "business;" thus, the German language version of the Convention uses the same word to refer to both.)

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 tax interest of its own 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 usable in the judicial proceedings of the requesting State. The requested State should, if possible, provide the information in the form requested to the same extent that it can obtain information in that form under its own laws and administrative practices with respect to its own taxes. Providing information in the form requested is a continuation of present practice.

Paragraph 4 clarifies that the tax authorities of a Contracting State may deliver documents to persons in the other Contracting State by using postal services. Each Contracting State shall, for purposes of its taxes, determine in accordance with its domestic law the legal efficacy or sufficiency of the documents so delivered.

Paragraph 5 clarifies that the information exchange provisions of this Article apply to assistance carried out under penal, as well as non-penal, investigation procedures. Paragraph 5 also provides that requests for arrest of persons are not covered by the Convention.

As discussed above, paragraph 6 provides that the information exchange provisions of this Article shall apply to taxes of every kind imposed by a Contracting State.

Paragraph 7 provides for assistance in collection of the taxes specified under Article 2 to the extent necessary to ensure that treaty benefits are enjoyed only by persons entitled to those benefits under the terms of the Convention. Under this paragraph, a Contracting State will endeavor to collect on behalf of the other State only those amounts necessary to ensure that any exemption or reduced rate of tax at source granted under the Convention by that other State is not enjoyed by persons not entitled to those benefits.

Subparagraphs a), b), c) and d) of paragraph 7 impose conditions on collection assistance. Under subparagraph a), the requesting State must produce a copy of a document certified by its competent authority specifying that the sums referred for collection assistance are finally due and enforceable. The tax of a requesting State shall be considered "finally due and enforceable" when the requesting state has the right under its internal law to collect the tax and all administrative and judicial rights of the taxpayer to retrain collection in the requesting State have lapsed or been exhausted. Thus, the concept of "finally due and enforceable" is equivalent to "finally determined" in the U.S. income tax treaties with Canada and

the Netherlands.

Under subparagraph b), a document described in subparagraph a) shall be rendered enforceable in accordance with the laws of the requested State. Under Austrian law, such documents must be rendered enforceable by the Regional Finance Directorates (Finanzlandesdirektionen). Where the U.S. Competent Authority accepts a request for collection assistance, the Austrian tax claim shall be treated by the United States as an assessment under United States laws against the taxpayer as of the time the request is received.

Under subparagraph c), the requested State shall effect recovery in accordance with the rules governing the recovery of similar tax debts of its own; however, tax debts to be recovered shall not be regarded as privileged debts in the requested State. This provision establishes the rule that a tax for which collection assistance is provided shall not have in the requested State any priority specially accorded to the taxes of the requested State. Thus, the priority enjoyed by the requested State for collection of its own taxes in relation to conflicting creditor claims (e.g., in bankruptcy) are not automatically extended to the tax claims of the requesting state.

Also under subparagraph c), in the Republic of Austria, judicial execution shall be requested by the Finanzrokuratur or by the finance office delegated to act on his behalf. Where the U.S. competent authority accepts a request for collection assistance, and judicial enforcement is required to effect such assistance, judicial enforcement will be requested and the matter will be referred to the Department of Justice as if the Austrian tax claim were a U.S. tax assessment.

Under subparagraph d), appeals concerning the existence or amount of the debt shall lie only to the competent tribunal of the requesting State.

Finally, paragraph 7 provides that the Contracting State asked to collect the tax is not obligated, in the process, to carry out administrative measures that are different from those used in the collection of its own taxes, or that would be contrary to its sovereignty, security, public policy or essential interests. Under the Memorandum of Understanding, the Contracting States agree that the "essential interest" clause above can be invoked by a Contracting State if requested to recover a tax on behalf of the other Contracting State and the requested State denies that the tax in question is levied in accordance with the provisions of the Convention.

Regarding all provisions of Article 25, the Memorandum of Understanding provides two clarifications. First, it is

understood that the requested State shall be obligated to obtain the requested information according to its procedures at the time of the request. Therefore, if either State undertakes new and more comprehensive procedures to obtain information for its own purposes, those procedures shall be used to obtain information under those procedures for the other Contracting State. Second, it is understood that this Article is not confined to taxes levied, or information coming into existence, after the Convention becomes effective. Therefore, it is clear that the date on which the information is exchanged is the relevant date for purposes of determining whether Article 25 applies. Thus, an exchange of information is within the scope of the Convention whether or not the information is in existence before, or the taxable year is before, the effective date of the Convention.

Article 26. DIPLOMATIC AGENTS AND CONSULAR OFFICERS

This Article confirms that any fiscal privileges to which diplomatic or consular officials are entitled under general provisions of international law or under special agreements will apply, notwithstanding any provisions to the contrary in the Convention. The agreements referred to include any bilateral agreements, such as consular conventions, that affect the taxation of diplomats and consular officials and any multilateral agreements, to which both Contracting States are parties, dealing with these issues, such as the Vienna Convention on Diplomatic Relations and the Vienna Convention on Consular Relations.

The saving clause of paragraph 4 of Article 1 (Personal Scope) does not apply, by virtue of the exceptions in subparagraph 5(b) of that Article, to override any benefits of this Article available to an individual who is neither a citizen of the United States nor has immigrant status there.

Article 27. APPLICATION OF THE CONVENTION

This Article provides that nothing in this Agreement shall be construed so as to preclude either Contracting State from applying any withholding tax systems according to its domestic laws. However, if the Convention provides for an exemption from or a reduction of tax and the amount withheld exceeds the limits imposed by the Convention, the excess shall be refunded upon the taxpayer's request.

Article 28. ENTRY INTO FORCE

This Article provides the rules for bringing the Convention into force and the general rules for the effective dates of 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 first day of the second month following the exchange of instruments of ratification. 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 on which the Convention enters into force. For all other income taxes, the Convention will have effect for fiscal periods beginning on or after the first day of January next following the date on which the Convention enters into force. Thus, if instruments are exchanged on October 15 of a year, the treaty will enter into force on December 1 of that year. It will have effect for withholding tax purposes for payments made or credited on or after February 1 of the next year. For other purposes, it will have effect for taxable years beginning on or after January 1 of that next year.

Paragraph 3 provides a general exception to the effective date rules of paragraph 2. Under this paragraph, if the 1956 Convention would have afforded greater relief from tax to a person entitled to its benefits than would be the case under this Convention, that person may elect to remain subject to all of the provisions of the 1956 Convention for the first assessment period or taxable year with respect to which this Convention would have had effect under the provisions of paragraph 2 of this Article.

With regard to the interpretation of paragraph 3, the intent is to allow the taxpayer to elect to extend the benefits of the old Convention for one year from the date on which the relevant provision of the new Convention would first take effect. For example, suppose the instruments of ratification are exchanged on February 1 of year 1 and the Convention thus enters into force on April 1 of year 1. The new Convention would take effect with respect to interest withholding for interest paid or credited on or after June 1 of the first year. If the election is made, the provisions of the old Convention regarding interest withholding would continue to have effect for interest paid or credited at any time prior to June 1 of the second year. With regard to assessed taxes, the new convention is applicable as of January 1 of year 2. Therefore, with respect to the branch tax, which is imposed on an assessment basis, an election would allow the old Convention to continue, thus preventing the imposition of the branch tax for the first taxable year beginning on or after January 1 of year 3.

Paragraph 4 provides that the 1956 Convention will cease to

have effect at the time this Convention takes effect under the provisions of paragraphs 2 and 3 of this Article.

Article 29. TERMINATION

The Convention is to remain in effect indefinitely, unless terminated by a Contracting State. The Convention may be terminated by either Contracting State at any time after 5 years from the date of its entry into force, provided that at least six months' prior notice has been given, in writing, through diplomatic channels. The termination will have effect in respect of tax withheld at source, for amounts paid or credited on or after, and in respect of other taxes, to fiscal periods beginning on or after, the first day of January next following the expiration of the six-month period. Thus, if notice is given prior to July 1 of any calendar year after the five-year period has elapsed, the provisions of the Convention will cease to have effect for withholding purposes with respect to any payment made or credited on or after January 1 of the following year, and for other purposes for taxable years beginning on or after January 1 of the following year.