United States response to United Kingdom note setting forth additional agreements regarding the U.S.-U.K. Double Taxation Convention, signed July 24, 2001, London

London
July 24, 2001

Sir:

I have the honour to acknowledge receipt of Your Excellency's note of today which reads as follows:

"I have the honour to refer to the Convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains which has been signed today and to make on behalf of the Government of the United Kingdom of Great Britain and Northern Ireland the following proposals:

With reference to paragraph 3 of Article 1 (General Scope):

it is understood that, at the time of the signing of the Convention, the only agreements in force as between the two Contracting States that may impose national treatment or most-favoured nation obligations are the General Agreement on Trade in Services, the General Agreement on Tariffs and Trade, A Convention to Regulate the Commerce between the Territories of the United States and of His Britannic Majesty, signed in London on July 3rd, 1815, and the Treaty of Amity, Commerce, and Navigation, between His Britannic Majesty and the United States of America, signed at London, on November 19th, 1794. If it is determined that there were, at the date of the signing of the Convention, additional agreements in force between the Contracting States that create such obligations, the Contracting States will consider whether amendments to the Convention are necessary to ensure the proper interaction of the Convention and such other agreement with respect to tax measures.

With reference to paragraph 6 of Article 1 (General Scope):

(1) it is understood that an individual shall be regarded as a former long-term resident of a Contracting State only if that individual (not being a citizen of that Contracting State) was a lawful permanent resident of that Contracting State in at least eight of the fifteen fiscal years ending with the fiscal year in which the individual ceased to be a long-term resident of that Contracting State;

(2) it is further understood that, in the case of an individual who is a former citizen of a Contracting State, the following factors shall be considered favourably in determining whether or not one of the principal purposes of that individual's loss of citizenship of that Contracting State was the avoidance of tax,

a) at the time of the individual's ceasing to be a citizen of that Contracting State or within a reasonable period thereafter, the individual is or becomes a resident fully liable to income tax in the other Contracting State, and

b) (i) the individual was a citizen of both Contracting States at birth and has remained a citizen of the other Contracting State;

(ii) at the time of the loss of such citizenship (or within a reasonable period thereafter), the individual was or became a citizen of the other Contracting State, and that other Contracting State was that individual's country of birth, or the country of birth of that individual's spouse or of either of that individual's parents;

(iii) in the 10 years preceding the loss of such citizenship the individual was present in that Contracting State for no more than 30 days in any taxable year or year of assessment; or

(iv) the loss of citizenship occurred before the individual attained the age of 18½ years;

(3) it is further understood that, in the case of an individual who is a former long-term resident of a Contracting State, the following factors shall be considered favourably in determining whether or not one of the principal purposes of that individual's ceasing to be a long-term resident of that Contracting State was the avoidance of tax,

a) at the time of the individual's ceasing to be a long-term resident of that Contracting State or within a reasonable period thereafter, the individual is or becomes a resident fully liable to income tax in the other Contracting State, and that other Contracting State is

(i) the country in which the individual was born;

(ii) the country in which the individual's spouse was born; or

(iii) the country where either of the individual's parents was born;

b) in the 10 years preceding the individual's ceasing to be a long-term resident of that Contracting State, the individual was present in that Contracting State for no more than 30 days in each taxable year or year of assessment; or

c) the individual ceases to be a long-term resident of that Contracting State before reaching the age of 18½ years; and

(4) it is understood that, for the purposes of sub-paragraph a) of paragraph (2) and sub-paragraph a) of paragraph (3) above, an individual is not to be regarded as fully liable to income tax in a Contracting State if that individual is subject to tax in that State, in respect of income arising in the other Contracting State, by reference to the amount of such income which is remitted to or received in the first-mentioned State and not by reference to the full amount thereof.

With reference to paragraph 8 of Article 1 (General Scope):

it is understood that where an item of income, profit or gain is derived through a person which is a resident of a Contracting State the provisions of the paragraph shall not prevent that Contracting State from taxing the item as the income, profit or gain of that person.

It is further understood that, where, by virtue of the paragraph, an item of income, profit or gain is considered by a Contracting State to be derived by a person who is a resident of that Contracting State, and the same item is considered by the other Contracting State to be derived by that person or by a person who is a resident of that other Contracting State, the paragraph shall not prevent either Contracting State from taxing the item as the income, profit or gain of the person considered by that State to have derived the item of income, profit or gain.

It is further understood that, in applying the paragraph, the United Kingdom shall, exceptionally, regard an item of income, profit or gain arising to a person as falling within the paragraph where another person is charged to United Kingdom tax in respect of that item of income, profit or gain

a) under section 660A or 739, Income and Corporation Taxes Act 1988; or

b) under section 77 or 86, Taxation of Chargeable Gains Act 1992.

It is further understood that, in applying the paragraph, a person shall be regarded as fiscally transparent under the laws of the United Kingdom in relation to an item of income, profit or gain where a charge is made on another person on that item either:

a) by virtue of section 13, Taxation of Chargeable Gains Act 1992; or

b) because that other person has (or, under section 118, Finance Act 1993, is treated as having) an equitable right in possession in a trust.

With reference to Article 2 (Taxes Covered):

it is understood that, if a political sub-division or local authority of the United States seeks to impose tax on the profits of any enterprise of the United Kingdom from the operation of ships or aircraft in international traffic, in circumstances where the Convention would preclude the imposition of a Federal income tax on those profits, the United States Government will use its best endeavours to persuade that political sub-division or local authority to refrain from imposing tax.

With reference to sub-paragraph o) of paragraph 1 of Article 3 (General Definitions):

it is understood that pension schemes shall include the following and any identical or substantially similar schemes which are established pursuant to legislation introduced after the date of signature of the Convention:

a) under the law of the United Kingdom, employment-related arrangements (other than a social security scheme) approved as retirement benefit schemes for the purposes of Chapter I of Part XIV of the Income and Corporation Taxes Act 1988, and personal pension schemes approved under Chapter IV of Part XIV of that Act; and

b) under the law of the United States, qualified plans under section 401(a) of the Internal Revenue Code, individual retirement plans (including individual retirement plans that are part of a simplified employee pension plan that satisfies section 408(k), individual retirement accounts, individual retirement annuities, section 408(p) accounts, and Roth IRAs under section 408A), section 403(a) qualified annuity plans, and section 403(b) plans.

With reference to Article 7 (Business Profits):

it is understood that the OECD Transfer Pricing Guidelines will apply, by analogy, for the purposes of determining the profits attributable to a permanent establishment. Accordingly, any of the methods described therein – including profits methods – may be used to determine the income of a permanent establishment so long as those methods are applied in accordance with the Guidelines. In particular, in determining the amount of attributable profits, the permanent establishment shall be treated as having the same amount of capital that it would need to support its activities if it were a distinct and separate enterprise engaged in the same or similar activities. With respect to financial institutions other than insurance companies, a Contracting State may determine the amount of capital to be attributed to a permanent establishment by allocating the institution's total equity between its various offices on the basis of the proportion of the financial institution's risk-weighted assets attributable to each of them.

With reference to paragraph 2 of Article 8 (Shipping and Air Transport):

it is understood 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 an enterprise of a Contracting State contracts to carry property from the other State to the first-mentioned State and, as part of that contract, it transports the property by truck from its point of origin to an airport in the other State (or it contracts with a trucking company to carry the property to the airport) the income earned by the enterprise from the overland leg of the journey would be taxable only in the first-mentioned State. Similarly, it is understood that Article 8 also would apply to income from lighterage undertaken as part of the international transport of goods.

With reference to Article 9 (Associated Enterprises), paragraph 4 of Article 11 (Interest) and paragraph 4 of Article 12 (Royalties):

it is understood that, if the amount of interest or royalties paid exceeds the amount that would have been paid in the absence of a special relationship, a Contracting State generally will adjust the amount of deductible interest or royalties paid under the authority of Article 9 and make such other adjustments as are appropriate. If such an adjustment is made, the Contracting State

making such adjustment will not also impose its domestic rate of withholding tax with respect to such excess amount.

With reference to paragraph 7 of Article 10 (Dividends):

it is understood that the general principle of the "dividend equivalent amount", as used in United States law, is to approximate that portion of the income mentioned in paragraph 7 of Article 10 that is comparable to the amount that would be distributed as a dividend if such income were earned by a subsidiary incorporated in the United States. For any year, a foreign corporation's dividend equivalent amount is equal to the after-tax earnings attributable to the foreign corporation's (i) income attributable to a permanent establishment in the United States, (ii) income from real property in the United States that is taxed on a net basis under Article 6 (Income from Real Property), and (iii) gain from a real property interest taxable by the United States under paragraph 1 of Article 13 (Gains), reduced by any increase in the foreign corporation's net investment in U.S. assets or increased by any reduction in the foreign corporation's net investment in U.S. assets.

With reference to Article 14 (Income from Employment):

it is understood that any benefits, income or gains enjoyed by employees under share/stock option plans are regarded as "other similar remuneration" for the purposes of Article 14.

It is further understood that where an employee:

a) has been granted a share/stock option in the course of an employment in one of the Contracting States;
b) has exercised that employment in both States during the period between grant and exercise of the option;
c) remains in that employment at the date of the exercise; and
d) under the domestic law of the Contracting States, would be taxable by both Contracting States in respect of the option gain,

then, in order to avoid double taxation, a Contracting State of which, at the time of the exercise of the option, the employee is not a resident will tax only that proportion of the option gain which relates to the period or periods between the grant and the exercise of the option during which the individual has exercised the employment in that Contracting State.

With the aim of ensuring that no unrelieved double taxation arises the competent authorities of the Contracting States will endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of Article 14 and Article 24 (Relief from Double Taxation) in relation to employee share/stock option plans.

With reference to paragraph 1 of Article 17 (Pensions, Social Security, Annuities, Alimony, and Child Support):

it is understood that a payment shall be treated as a pension or other similar remuneration under

paragraph 1 of Article 17 if it is a payment under a pension scheme as defined in sub-paragraph o) of paragraph 1 of Article 3 (General Definitions) of the Convention.

With reference to sub-paragraph b) of paragraph 3 and sub-paragraph d) of paragraph 5 of Article 18 (Pension Schemes):

it is understood that the pension schemes listed with respect to a Contracting State in this exchange of notes in connection with sub-paragraph o) of paragraph 1 of Article 3 (General Definitions) shall generally correspond to the pension schemes listed in this exchange of notes with respect to the other Contracting State.

With reference to paragraph 1 of Article 22 (Other Income):

it is understood that the purpose of the exclusion from the paragraph for income paid out of trusts or the estates of deceased persons in the course of administration is to allow a recipient of such income the relief that would have been available to him under the provisions of the Convention had he received the income direct instead of through the trust or estate.

With reference to Article 23 (Limitation on Benefits):

it is understood that the term "gross income" means the total revenues derived by a resident of a Contracting State from its principal operations, less the direct costs of obtaining such revenues.

With reference to paragraph 4 of Article 23 (Limitation on Benefits):

it is understood that an item of income, profit or gain is to be considered as derived "in connection" with an active trade or business in a Contracting State if the activity generating the item in the other Contracting State is a line of business which forms a part of, or is complementary to, the trade or business conducted in the first-mentioned State. The line of business in the first-mentioned State may be 'upstream' to that going on in the other State (e.g., providing inputs to a manufacturing process that occurs in that other State), 'downstream' (e.g., selling the output of a manufacturer which is a resident of the other State) or 'parallel' (e.g., selling in one Contracting State the same sorts of products that are being sold by the trade or business carried on in the other Contracting State).

It is understood that an item of income, profit or gain derived from a Contracting State would be considered "incidental" to the trade or business carried on in the other Contracting State if the item is not produced by a line of business which forms a part of, or is complementary to, the trade or business conducted in that other Contracting State by the recipient of the item, but the production of such item facilitates the conduct of the trade or business in that other Contracting State. An example of such "incidental" item of income, profit or gain is interest income earned from the short-term investment of working capital of a resident of a Contracting State in securities issued by persons in the other Contracting State.

With reference to paragraph 6 of Article 23 (Limitation on Benefits):

it is understood that in applying paragraph 6 of Article 23, the competent authorities will consider the obligations imposed upon the United Kingdom by its membership of the European Community and by its being a party to the European Economic Area Agreement, and on the United States by its being a party to the North American Free Trade Agreement. In particular, they will have regard to any legal requirements for the facilitation of the free movement of capital and persons, the differing internal tax systems, tax incentive regimes and existing tax treaty policies among Member States of the European Community or European Economic Area states, or, as the case may be, parties to the North American Free Trade Agreement.

Paragraph 6 of Article 23 requires the competent authority of the State from which benefits are claimed to consider whether the establishment, acquisition or maintenance of a resident and the conduct of its operations had as one of its principal purposes the obtaining of benefits under the Convention. That competent authority may determine under a given set of facts that a change in circumstances that would cause a qualified person to cease to qualify for treaty benefits under paragraph 2 of Article 23 need not result in a denial of benefits. Such changes in circumstances may include:

a) a change in the state of residence of a major participator in a company;

b) the sale of part of the ownership interests in a company to a resident of another Member State of the European Community or another European Economic Area state or, as the case may be, another party to the North American Free Trade Agreement; or

c) an expansion of a company's activities in other Member States of the European Community or other European Economic Area states or, as the case may be, other parties to the North American Free Trade Agreement,

all under ordinary business conditions.

If the competent authority is satisfied that these changed circumstances are not attributable to tax avoidance motives, this will be a factor weighing in favour of granting benefits in accordance with paragraph 6 of Article 23.

With reference to sub-paragraph e) of paragraph 7 of Article 23 (Limitation on Benefits):

it is understood that, if a class of shares was not listed on a recognised stock exchange in the twelve months referred to in the sub-paragraph, that class of shares will be treated as regularly traded only if that class meets the aggregate trading requirements of the sub-paragraph for the taxable or chargeable period in which the income arises.

With reference to Article 24 (Relief from Double Taxation):

it is understood that, under paragraph 4 or 8 of Article 1 (General Scope), the provisions of the Convention may permit the Contracting State of which a person is a resident (or, in the case of

the United States, a citizen), to tax an item of income, profit or gain derived through another person (the entity) which is fiscally transparent under the laws of either Contracting State, and may permit the other Contracting State to tax

a) the same person;

b) the entity; or

c) a third person

with respect to that item. Under such circumstances, the tax paid or accrued by the entity shall be treated as if it were paid or accrued by the first-mentioned person for the purposes of determining the relief from double taxation to be allowed by the State of which that first-mentioned person is a resident (or, in the case of the United States, a citizen), except that, in the case of an item of income from real property to which paragraph 1 of Article 6 (Income from Real Property) of the Convention applies, or a gain from the alienation of real property to which paragraph 1 of Article 13 (Gains) applies, the tax paid or accrued by the person who is a resident of the Contracting State in which the real property is situated shall be treated as if it were paid or accrued by the person who is a resident of the other Contracting State.

In the case where the same item of income, profit or gain derived through a trust is treated by each Contracting State as derived by different persons resident in either State, and

a) the person taxed by one State is the settlor or grantor of a trust; and

b) the person taxed by the other State is a beneficiary of that trust,

the tax paid or accrued by the beneficiary shall be treated as if it were paid or accrued by the settlor or grantor for the purposes of determining the relief from double taxation to be allowed by the State of which that settlor or grantor is a resident (or, in the case of the United States, a citizen), except that, in the case of an item of income from real property to which paragraph 1 of Article 6 (Income from Real Property) of the Convention applies, or a gain from the alienation of real property to which paragraph 1 of Article 13 (Gains) applies, the tax paid or accrued by the person who is a resident of the Contracting State in which the real property is situated shall be treated as if it were paid or accrued by the person who is a resident of the other Contracting State.

It is further understood that paragraphs 2 and 5 of Article 24 shall apply to such an item of income, profit or gain to the extent necessary to provide relief from double taxation.

With reference to paragraphs 1 and 4 of Article 24 (Relief from Double Taxation):

it is understood that, if a resident of a Contracting State receives a dividend that is described in sub-paragraph b) of paragraph 1 or sub-paragraph b) of paragraph 4 of Article 24, such dividend will be deemed to be income from sources in the other Contracting State, even if it may be taxed

only in the first-mentioned Contracting State because of sub-paragraph a) of paragraph 3 of Article 10 (Dividends).

With reference to paragraph 2 of Article 26 (Mutual Agreement Procedure):

it is understood that where the competent authorities are endeavouring to resolve a case pursuant to the Article, neither Contracting State shall seek to collect the tax which is in dispute until the mutual agreement procedure has been completed. Any tax which is payable following the completion of the mutual agreement procedure shall, however, be subject to interest charges, and, if appropriate, surcharges or penalties, as long as it remains unpaid.

With reference to paragraph 3 of Article 26 (Mutual Agreement Procedure):

it is understood that any principle of general application established by an agreement between the competent authorities shall be published by both competent authorities.

With reference to Article 27 (Exchange of Information and Administrative Assistance):

it is understood that the powers of each Contracting State's competent authorities to obtain information include powers to obtain information held by financial institutions, nominees, or persons acting in an agency or fiduciary capacity (not including information that would reveal confidential communications between a client and an attorney, solicitor or other legal representative, where the client seeks legal advice), and information relating to the ownership of legal persons, and that each Contracting State's competent authorities are able to exchange such information in accordance with the Article.

With reference to Article 29 (Entry into Force):

it is understood that the provisions of Article 26 (Mutual Agreement Procedure) and Article 27 (Exchange of Information and Administrative Assistance) of the Convention shall have effect from the date of entry into force of the Convention, without regard to the taxable or chargeable period to which the matter relates.

In General:

it is understood that the two Governments shall consult together at regular intervals regarding the terms, operation and application of the Convention to ensure that it continues to serve the purposes of avoiding double taxation and preventing fiscal evasion and shall, where they consider it appropriate, conclude Protocols to amend the Convention. The first such consultation shall take place no later than December 31st in the fifth year following the date on which the Convention enters into force in accordance with the provisions of Article 29 (Entry into Force). Further consultations shall take place thereafter at intervals of no more than five years.

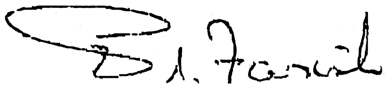
Notwithstanding the preceding paragraph, either Government may at any time request consultations with the other Government on matters relating to the terms, operation and application of the Convention which it considers require urgent resolution.

If the foregoing proposals are acceptable to the Government of the United States of America, I have the honour to suggest that the present note and Your Excellency's reply to that effect should be regarded as constituting an agreement between the two Governments in this matter, which shall enter into force at the same time as the Convention."

The foregoing proposals being acceptable to the Government of the United States of America, I have the honour to confirm that Your Excellency's note and this reply shall be regarded as constituting an agreement between the two Governments in this matter which shall enter into force at the same time as the Convention.

Accept, Excellency, the renewed assurance of my high consideration.

Sincerely,



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