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Fact Sheet for the Chairman, Subcommittee on Commerce, Consumer and Monetary Affairs, Committee on Government Operations, House of Representatives

September 1987

IRS/TREASURY

Tax Withholding Systems Used by U.S. Tax Treaty Partners

RELEASED

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September 11, 1987

The Honorable Doug Barnard, Jr.
Chairman, Subcommittee on Commerce,
Consumer and Monetary Affairs
Committee on Government Operations
House of Representatives

Dear Mr. Chairman:

This fact sheet responds to a request from your office that we describe the types of withholding systems used by U.S. tax treaty partners when taxing passive income (dividends, interest, rents, and royalties) earned by foreign persons. Specifically, this report presents (1) a summary table of withholding systems currently in use, which we developed on the basis of responses by 27 countries to a Department of the Treasury letter of inquiry sent during the latter part of 1982 and early 1983, Internal Revenue Service (IRS) input, and 1984/1985 pamphlets on taxation in foreign countries (see app. I); and (2) descriptions of each of the 27 countries' withholding systems (see app. II).

Your office also requested that we obtain both a description of and statistics on IRS' procedure for providing residency certification statements to U.S. taxpayers seeking reduced tax rates in tax treaty countries. Appendix III contains an IRS publication describing the procedure to be followed by U.S. taxpayers seeking U.S. certifications. Under these procedures, IRS service center personnel do not certify U.S. residency but rather certify that for the given tax year the individual filed a U.S. income tax return. We were unable to obtain data from IRS on the number of U.S. certifications issued. According to an IRS official, such statistics are not maintained.

BACKGROUND

Evidence presented at your Subcommittee's June 1982 hearings on the improper use of foreign addresses to evade U.S. taxes indicated that the United States was losing millions of tax dollars annually. U.S. citizens and foreign persons who reside in countries without tax treaties were evading the withholding tax on certain U.S. source income by falsely claiming residency through the reporting of addresses or bank accounts located in countries that were U.S. tax treaty partners. This practice allowed the U.S. citizen or foreign person to wrongfully obtain a reduction of or exemption from U.S. withholding tax. Testimony at the hearings also indicated that the address-based system of tax withholding used by IRS was particularly vulnerable to this abuse.

In September 1982, Congress enacted Section 342 of the Tax Equity and Fiscal Responsibility Act of 1982 to combat potential abuses by foreign persons in obtaining reduced withholding rates under U.S. tax treaties. Section 342 required the Department of the Treasury to develop, by September 1984, new procedures to prevent further abuse. Toward that end, Treasury sent a letter of inquiry to 42 U.S. treaty partners concerning their methods of providing treaty benefits to foreign persons. Treasury hoped that knowledge of the systems used by U.S. treaty partners would help them devise a more effective way of administering U.S. treaty benefits. Although Treasury has proposed regulations aimed at meeting the requirements of section 342, as of August 31, 1987, the regulations had not been implemented.

Types of withholding systems used to tax passive income earned by foreign persons

Treasury's letter of inquiry describes three basic types of withholding systems used by U.S. tax treaty partners.

Address system

Countries using the address system reduce or eliminate withholding taxes on passive income when the income is paid to foreign persons who declare or self-certify that they reside in a tax treaty country. Income recipients are not generally required to provide independent certifications verifying their residency.

Certification system

Countries using the certification system exempt foreign persons from passive income withholding or reduce the amount withheld when the payee presents a certificate of residence. Most of the countries using this system require that the certificate be issued by the tax authority of the country in which the payee claims residence. Some countries will accept certificates from the payee's financial institution.

Refund system

Countries using the refund system require that taxes be withheld at the full rate when passive income is paid to the foreign person. The person, if eligible for exemption from or reduced withholding, may then submit a claim for refund. Before issuing a refund, most countries require the same type of evidence needed under the certification system.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective was to identify and describe the types of withholding systems used by U.S. tax treaty countries when taxing passive income earned by foreign persons.

We obtained from IRS' files 29 of 31 answers that IRS officials said had been received in response to Treasury's letter of inquiry. The other two responses could not be located. In analyzing that information, we excluded two responses, one from Iceland and the other from an unidentified country. Iceland was excluded because that country does not use a withholding system to collect tax from foreign investors. Information from the remaining 27 responses is summarized in appendix I and presented in country-by-country detail in appendix II.

We compared the information we received from IRS with Peat, Marwick, Main & Co. pamphlets about taxation in foreign countries. These pamphlets were available for 12 of the 27 countries whose responses we reviewed. That comparison disclosed no discrepancies in our data. Secondly, we asked IRS' Office of the Assistant Commissioner (International) to review appendixes I and II.

In an August 24, 1987, letter to GAO, IRS' Assistant Commissioner (International) said that, with few exceptions, IRS found appendixes I and II to "generally correspond with our knowledge of these practices." The noted exceptions involved providing either additional or more current information on the various countries' withholding systems. For example, IRS said that subsequent to its 1983 response, Greece changed from a certification system to a refund system. IRS also identified three countries, Belize, the Gambia, and Sierra Leone, with which the United States no longer has a tax treaty.

Additionally, IRS provided a brief description of Italy's system for administering tax treaty benefits. This country was omitted from our fact sheet because it had not responded to Treasury's letter of inquiry. IRS stated that Italy uses a certification-based system in which "an official certification that all of the conditions specified in the treaty for a reduced rate or an exemption is required to be submitted to Italian payors to obtain reduced withholding at source." The above information and other comments IRS made regarding how we characterized certain countries' withholding systems were considered and, where appropriate, were incorporated into this fact sheet.

RESULTS OF OUR REVIEW

Of the 27 countries we reviewed, 10 use the address system for some types of income and 3 others use it only under certain circumstances. Austria, for example, uses the address system only for dividends paid to companies in the Netherlands. Of the 10 countries that use the address system, 4 require residency certifications or additional information from the treaty country when doubt exists regarding the veracity of the information provided by the foreign person.

Seven countries indicated that they used the refund system for some or all types of passive income. Twenty-one countries, including four of the seven cited above, use the refund system as a "backup." In these situations, the countries withhold for the full amount when address and certification-based system requirements are not met, i.e., residency certifications are either not submitted or not available from the foreign country. Also, the refund system may be the only system permitted under certain tax treaties. In summarizing the country responses, we did not categorize countries that use the refund system for backup purposes as having a refund system.

The certification system is the most widely used system in the 27 countries we reviewed. Fourteen of the countries use the certification system for all or some categories of income. These countries include Belgium, France, Luxembourg, Sweden, West Germany, and the United Kingdom.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this document until 30 days from the date of issuance. At that time, we will send copies to IRS, to congressional committees having an interest in the information presented, and to other interested parties. If you or your staff have questions regarding this information, please contact David Attianese of my staff on 376-0023.

Sincerely yours,

Jennie S. Stathis

Jennie S. Stathis
Associate Director

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SUMMARY TABLE OF WITHHOLDING SYSTEMS USED BY U.S. TAX TREATY PARTNERS WHEN APPLYING TREATY BENEFITS TO PASSIVE INCOME EARNED BY FOREIGN PERSONS

Tax treaty country	Type of withholding system for interest (I), dividends (D), or rental or royalty (R) income		
	Address	Certification	Refund
1. Australia	D,R	b	a,o
2. Austria	c	a	D,c
3. Barbados	a	I,D,R	a,o
4. Belgium	a	R	I,D,o
5. Belize n	a	I,D,R	a,o
6. Canada	I,D,R	d	a,o
7. Denmark	a	a	D
8. France	a	I,D,R	a,o
9. Gambia n	a	I,D,R	a,o
10. Greece	a	a	I,D,R
11. Hungary	a	I,D,R	a
12. Japan	I,D,R	a	a,o
13. Korea	I,D,R	e	a,o
14. Luxembourg	a	I,D,R	I,f,o
15. Malta	a	I,D,R	a,o
16. Netherlands	g	D	g,o
17. New Zealand	I,D,R	h	a
18. Norway	D	a	a,o
19. Philippines	I,D,R	i	a,o
20. Poland	I,D,R	a	a,o
21. Sierra Leone n	a	I,D,R	a,o
22. Sweden	a	D	j,o
23. Switzerland	a	a	I,D
24. Trinidad and Tobago	I,D,R	I,k	a
25. USSR	I,R	a	a,o
26. United Kingdom	a	I,D,R	l,o
27. West Germany	m	R	I,D,o

[a]Withholding tax system not used for applying treaty benefits to foreign investors.

[b]Australia makes inquiries regarding residential status in cases where doubt exists. When necessary, Australia seeks certifications.

[c]Austria uses an address system for dividends paid to certain companies in the Netherlands. Also, Austria uses a refund procedure for royalty income earned under the Austria-Liechtenstein tax treaty.

[d]Canada requires certifications only when doubt exists regarding the veracity of information the payor receives.

[e]Korea uses a certification system for residents of Belgium and the Netherlands.
[f]Luxembourg uses a refund system for certain bond interest.
[g]The Netherlands uses an address system for dividends paid to U.S. residents. A refund system is used for dividends paid to Swiss, Italian, and Israeli residents.
[h]New Zealand requires certifications only when doubt exists concerning the validity of an address.
[i]The Philippines requires information, other than the address, only in cases where doubt exists. A residency certification is required if the transaction involves the foreign person's government.
[j]Sweden uses a refund system for transactions covered under the Sweden-Switzerland tax treaty.
[k]Trinidad and Tobago uses a certification system only for interest paid to financial institutions and brokerage houses.
[l]The United Kingdom uses a refund system for dividends paid from portfolio shareholding and for dividends paid to non-United Kingdom financial institutions.
[m]West Germany uses a simplified procedure, similar to an address system, for small income payments.
[n]According to IRS, these countries no longer have a tax treaty relationship with the United States.
[o]The refund system is used as a "backup" when address and certification-based requirements are not met or when the refund system is the only system permitted by the countries' tax treaty.

Definitions of Passive Income Types

Interest (I)	Payment made in exchange for the use of money or credit over time.
Dividend (D)	Payment made to stockholders to distribute the earnings of a corporation.
Royalty and/ or rental income (R)	Royalty payments are made for the privilege of using patents, trademarks, and similar rights to the product's author, inventor, etc. These payments are called "license fees" in some countries. Rental payments compensate the owners of land, etc., for the use of their property.

Sources: Developed by GAO from responses to Treasury's letter of inquiry, IRS input, and 1984/1985 pamphlets on taxation in foreign countries authored by Peat, Marwick, Main & Co.

INDIVIDUAL COUNTRY DESCRIPTIONS OF THEIR WITHHOLDING SYSTEMS

Australia

Australia uses an address system

Australia uses an address system for determining whether foreign persons are entitled to treaty benefits. For dividends, Australia accepts recipient addresses when determining whether they are entitled to treaty benefits. For royalties, further inquiry, such as an examination of the royalty agreement, is usually necessary. No treaty benefits are available for interest because the withholding rate is 10 percent under both domestic tax law and under Australia's tax treaties with foreign countries. When doubt exists about a person's residence, specific inquiries may be initiated with the appropriate treaty partner. When necessary, Australian tax authorities seek certificates of residence.

Source: Response dated April 15, 1983, to IRS from Australia's Commissioner of Taxation.

Austria

Austria uses a refund system with one exception

Except as noted below, Austria uses a refund system for withholding on passive income earned by foreign persons. A refund application, providing self-certification, must be submitted within 5 years following the end of the year in which the tax was withheld. Austria uses its refund system primarily for dividends because Austria does not tax interest earned by foreign persons. However, Austria's tax treaty with Liechtenstein also includes a refund procedure for royalty income.

The one exception to Austria's use of a refund system involves dividends paid to certain companies in the Netherlands. For those companies, as specified in the Austria/Netherlands tax treaty, Austria uses an address system.

Austrian tax authorities issue residency certifications for their own residents upon request.

Source: Response dated February 25, 1983, to IRS from Austria's Minister for Finance, and Peat, Marwick, Main & Co.'s Taxation of Foreign Nationals in Europe.

Barbados

Barbados uses a certification system

Barbados requires a certificate of residence from the tax authority of the foreign person applying for reduced withholding. In addition, Barbados requires certification for each year foreign persons request reduced withholding. Barbados has formally established certification procedures with one country, the United Kingdom.

Although Barbados generally requires that tax authorities of the treaty countries provide certifications for their residents, it has on rare occasions allowed attorneys/accountants to submit their clients' tax returns as proof.

Source: Response dated March 16, 1983, to IRS from the Barbados Department of Inland Revenue.

Belgium

Belgium uses a certification system for royalty income

Belgium uses a certification system for withholding on royalty income earned by foreign persons. Belgium requires that the certification be provided by the tax authority in the country where the foreign person resides. Generally, such certifications are required for each royalty payment and should attest that the foreign person receiving the income is a resident and has filed an income tax return in the treaty partner country.

Belgium uses a refund system for dividend and interest income

Generally, Belgium uses a refund system as the primary withholding system for dividend and interest income earned by foreign persons. The Belgium withholding tax is normally 20 percent of dividend and interest payments made to foreign investors. In addition, Belgium uses the refund system for royalty income when withholding agents do not reduce withholding at the time the payment is made because a certification was not presented.

Belgium requires the same type of certification for a refund as is required under the certification system. Upon request by the foreign person, Belgium refunds taxes withheld from each revenue payment. Foreign persons have 3 years from the end of the year the income was paid to apply for a refund.

Source: Response dated November 3, 1983, to IRS from the Belgium Ministry of Finances, and Peat, Marwick, Main & Co.'s Taxation of Foreign Nationals in Europe.

Belize

Belize uses a certification system

Belize uses a certification system for withholding on passive income earned by foreign persons. Under this system, foreign persons must obtain a "Certificate of Assessment and Payment" from the tax authority of the treaty partner country to show their eligibility for treaty benefits. Belize does not vary its certification requirements on a treaty-by-treaty basis.

Belize provides certifications for its residents to all treaty partners.

Source: Response dated May 10, 1983, to IRS from the Belize Income Tax Department.

Canada

Canada generally uses an address system

Canada generally uses an address system to determine whether foreign persons are entitled to reduced withholding in accordance with bilateral tax treaties on passive income earned in Canada. The payor, who is usually the withholding agent, can accept the name and address given him or her to be that of the beneficial owner. However, if the payor has reason to suspect the information is not valid, he or she can require the payee to provide the proper certification.

Canada has special procedures for Swiss payees

Switzerland is unable to provide Canada with names and addresses of beneficial owners under its banking system. Therefore, Switzerland and Canada entered into an agreement that allowed Canadian payors to apply Canada-Switzerland reduced treaty rates for all income payments made to Swiss addresses. In return, Swiss government officials have agreed to take responsibility for collecting and remitting to Canada any additional tax for income paid to beneficial owners residing outside Switzerland.

Canada uses a certification system in certain situations

Canada requires certifications when there is doubt regarding the veracity of information the payor receives. Canada also requires updated certifications when there is a change, other than the amount of the income payment, that affects the amount of tax to be withheld. Certificates are to be submitted by either the beneficial owners or their agents or nominees.

Canada provides certifications for Canadian residents to any country upon request.

Source: Response dated March 2, 1983, to IRS from Canada's Deputy Minister for Taxation.

Denmark

Denmark uses a refund system

Denmark uses a refund system for withholding on dividends paid to foreign persons. Denmark does not withhold tax at source on interest and royalties. Instead, Danish firms withhold 30 percent of dividends at the time of payment. Shareholders of treaty partners entitled to treaty benefits then request the forms needed to seek refunds. The application form for a refund is to be certified by the foreign person's tax authority in his/her state of residence. Denmark uses the refund system for all its treaty partners, although the withholding rate does vary from treaty to treaty.

Source: Response received by IRS on March 2, 1983, from Denmark's Tax Department; Peat, Marwick, Main & Co.'s Taxation of Foreign Nationals in Europe; and an August 24, 1987, letter to GAO from IRS' Assistant Commissioner (International).

France

France uses a certification system

France uses a certification system to reduce the amount of taxes withheld on dividends, interest, and royalties. The full rate of withholding is 25 percent on dividends, 33 1/3 percent on royalties, and between 25 and 50 percent on interest. For reduced withholding, foreign persons must provide the French payor, who is usually the withholding agent, with a document certifying that the foreign person is a resident of a treaty partner country. Generally, the certification as to residence must come from the tax authority of the treaty partner country. For U.S. residents, however, the U.S./France tax treaty allows certification of residency by a U.S. financial institution rather than by IRS. France's certification form provides space for IRS to certify that the income recipient filed a U.S. income tax return. However, IRS completes this portion of the certificate only if income recipients are unable to obtain certification from their financial institution.

Source: Response dated February 16, 1983, to IRS from France's Ministry of Economics and Finances, and February 28, 1984, testimony by William J. Anderson, Director, General Government Division, U.S. General Accounting Office, on Federal Government Efforts to Prevent Tax Treaty Abuses.

Gambia

Gambia uses a certification system

The Republic of Gambia uses a certification system to apply treaty benefits to eligible foreign persons earning passive income in Gambia. Gambia's system requires certification every time a foreign person files to obtain treaty benefits unless the foreign person has already obtained a certification for the same financial year. The certificate submitted should contain a statement that the foreign person has filed a tax return and is a resident of the treaty partner country. Also, the certificate should be provided by the tax authority of the treaty partner and be filed with Gambia's Income Tax Office. Gambia does not vary its certification requirements on a treaty-by-treaty basis.

Gambia provides certifications for its residents to most European countries.

Source: Response dated March 26, 1983, to IRS from Gambia's Income Tax Office.

Greece

Greece uses a refund system

Greece uses a refund system to administer the granting of treaty benefits to eligible foreign persons. In using the refund system, Greece requires withholding at the full rate as provided by Greek law. Foreign persons seeking treaty benefits may then file for refunds. Generally, Greece requires official certification from the foreign person's tax authority as the basis for granting refunds. However, Greece will accept certifications for U.S. residents which state that a U.S. tax return was filed rather than declaring that the foreign person is a U.S. resident.

Source: Response dated February 21, 1983, to IRS from Greece's Ministry of Finance; a followup letter dated February 15, 1985, from Greece's Ministry of Finance to IRS; Peat, Marwick, Main & Co.'s Taxation of Foreign Nationals in Europe; and a letter dated August 24, 1987, to GAO from IRS' Assistant Commissioner (International).

Hungary

Hungary uses a certification system

Hungary uses a certification system in determining whether foreign persons are eligible for exemption or reduced withholding on passive income earned in Hungary as provided in Hungary's bilateral tax treaties. Hungary does not require certification in all cases, however. Instead, certification is required when it seems necessary. (Hungary's response did not describe when certification is deemed necessary.) When a certification is required, the tax authority in the treaty partner country must supply the certificate. The foreign person seeking the treaty benefit presents the certificate to the withholding agent. Hungary does not vary its certification requirements among its treaty partners.

Hungary provides certifications for its own residents when required.

Source: Response dated February 11, 1983, to IRS from Hungary's tax authority.

APPENDIX II

Japan

Japan uses an address system

Japan uses a withholding system that most closely resembles an address system. In Japan, foreign persons apply for reduced withholding rates, provided by tax treaties, by submitting to the Japanese payor an "Application Form for Income Tax Convention." This form identifies the foreign person as well as the type of income received and the specific treaty benefit being sought. Japan uses this same procedure for all types of income paid to foreign persons under bilateral tax treaties.

Japan provides certifications to its treaty partners for Japanese residents.

Source: Response dated February 28, 1983, to IRS from Japan's Ministry of Finance, National Tax Administration, and Peat, Marwick, Main & Co.'s Taxation in Japan.

Korea

Korea generally uses an address system

Except as discussed below, Korea uses an address system to determine whether a foreign person is eligible for an exemption from or reduced withholding for such earned income as interest, dividends, and royalties. For interest and dividends, Korea imposes a withholding tax of 10 percent. Korean tax authorities accept various documents to show that the foreign person is a resident of a country with which Korea has a tax treaty. These documents include: (1) documents relating to foreign capital permission statements issued by the Minister of Finance; (2) foreign exchange payment permission certificates issued by foreign exchange banks; (3) documents in the alien registration file maintained by the Ministry of Justice; and (4) other contract papers. The Korean government does not require any documents other than those described above.

Korea continues to use the address system because the Korean government regulates all payments of foreign exchange to foreign persons in accordance with foreign capital and exchange laws. In addition, the Korean government regulates all contracts with foreign persons resulting in foreign exchange.

Korea uses a certification system for Belgium and the Netherlands

Korea uses a certification system for residents of Belgium and the Netherlands. The certificate must include a statement certifying that the foreign person is a resident of one of those two countries. Korea also requires that the certificate be provided by a chief in a district tax office of a treaty partner.

Source: Response dated February 2, 1983, to IRS from Korea's National Tax Administration, and Peat, Marwick, Main & Co.'s Taxation in Korea.

Luxembourg

Luxembourg generally uses a certification system

Luxembourg uses a certification system to determine whether a foreign person is entitled to a reduction in withholding on interest, dividend, and royalty income. The document of proof Luxembourg uses is valid for 1, 2, or 3 years, depending on the treaty. This document contains a declaration by the income recipient that he or she is the resident of one of Luxembourg's treaty partners. Such residency has to be certified as true by that country's tax administration. The document is prepared in triplicate with one copy going to the Luxembourg tax authority, one to the competent tax office of the income payor (usually the withholding agent), and one to the payor. Other than the duration of the certificates, certification requirements do not vary on a treaty-by-treaty basis.

Luxembourg provides certificates for its own residents to Luxembourg's treaty partners.

Luxembourg uses a refund system for certain interest

Luxembourg uses a refund system for interest earned on certain bonds. A document of proof, which should contain the same information as the document used for certification, is required for each refund request. The lapse between the time tax is withheld and the time tax is refunded varies depending on the treaty.

Source: Response dated February 24, 1983, to IRS from Luxembourg's Office of Direct and Excise Taxes and Peat, Marwick, Main & Co.'s Taxation of Foreign Nationals in Europe.

Malta

Malta uses a certification system

Malta uses a certification system for dividend, interest, and royalty income. To exempt or reduce withholding, foreign persons submit a certified statement that they are residents of a treaty country. The certification should come from the tax authority of the treaty partner.

Malta also provides certifications for its own residents to other countries.

Source: Response dated January 4, 1983, to IRS from Malta's Office of Inland Revenue.

The Netherlands

The Netherlands generally uses a certification system

Except as noted below, the Netherlands uses a certification system to tax passive income earned by foreign persons. The Netherlands uses a certification system for dividends (outgoing interest and royalties are not taxed at the source) to allow reduction of the 25 percent Dutch dividend tax for residents of treaty partners. A certification form must be filed by the foreign person for each payment. Included on the certification form is space for a certificate of residence to be completed by the foreign person's competent tax authority.

The Netherlands uses an address system for U.S. residents

An exception to Netherlands' certification system involves dividends earned by U.S. residents in the Netherlands. According to Netherlands' response to Treasury, this exception was necessitated by the fact that "the United States tax administration has in the past been unable to cooperate by issuing certificates of residence . . . ." In order to obtain some assurance that the foreign person is a U.S. resident, residents of the United States who receive their Dutch dividends through a bank are required to provide a banker's affidavit.

The Netherlands uses a refund system for some countries

The Netherlands uses a refund system for dividends paid to residents of Switzerland, Italy, and Israel. The Netherlands uses a refund system for Israeli investors due to Israeli legislation which precludes the issuance of residency certifications.

Source: Response dated March 7, 1983, to IRS from the Netherlands' Ministry of Finance, and Peat, Marwick, Main & Co.'s Taxation of Foreign Nationals in Europe.

New Zealand

New Zealand uses an address system

New Zealand uses an address system to determine whether foreign persons are eligible to receive tax treaty benefits. The full rate of withholding is 15 percent on royalty and interest income and 30 percent on dividend income. These rates are reduced to the limits prescribed in the various tax treaties New Zealand has with other countries. However, if any suspicion exists concerning the validity of an address, New Zealand requires certification by the treaty partner's relevant tax authority.

Source: Response dated November 15, 1982, to IRS from New Zealand's Inland Revenue Department.

Norway

Norway uses an address system

Norway uses an address system for withholding on dividend payments to foreign persons. Norway does not withhold tax on interest and royalty income earned by foreign persons. Norwegian companies are required to provide the Norwegian tax administration with lists containing the names and addresses of their shareholders. It is generally assumed that the addresses are correct, and shareholders with addresses in treaty countries receive a reduction from Norway's 25 percent withholding tax on dividends. The lists are returned to the companies only when addresses are obviously wrong or incomplete.

Source: Response dated February 24, 1983, to IRS from Norway's tax authority, and Peat, Marwick, Main & Co.'s *Taxation of Foreign Nationals in Europe*.

The Philippines

The Philippines uses an address system

The Philippines uses an address system for determining whether foreign persons are entitled to exempt or reduced withholding on passive income earned in the Philippines in accordance with tax treaties. The Philippines' requires additional information (other than the address) only in "doubtful cases." The Philippines' response did not indicate what might raise doubts about a case.

The Philippines uses a certification system in special situations

The Philippines requires a certification of residence when eligibility for treaty benefits depends on the nature of the taxable transaction rather than the foreign person's citizenship, such as when a public entertainer's visit is sponsored by the entertainer's government.

Source: Response dated November 24, 1982, to IRS from the Philippines tax authority.

Poland

Poland uses an address system

Poland uses an address system for dividends, interest, and royalties.

Poland does not use a certification system, but it does provide certification for Polish residents to file with certain countries. Polish residents fill out forms stating the sum of each payment, and these forms are provided to the country in which taxable income arises. In addition, these forms are certified by the Polish tax authorities.

Source: Response dated February 8, 1983, to IRS from Poland's Advisor to the Minister of Finance.

Sierra Leone

Sierra Leone uses a certification system

Sierra Leone uses a certification system to apply treaty benefits to eligible foreign persons. A foreign person seeking treaty benefits needs a certification every time treaty benefits are requested. Certification requires a statement that (1) the person is a resident of a treaty partner country and (2) the person's income is subject to tax. Sierra Leone requires that the tax authorities of the treaty partners provide the certifications and that the foreign persons present them directly to Sierra Leone's tax agency. Certification requirements may vary depending on the conditions for exemption or reduction provided in each treaty.

Also, Sierra Leone provides certifications for its residents to any country with which it has a bilateral tax treaty.

Source: Response dated March 21, 1983, to IRS from Sierra Leone's Commissioner of Income Tax.

Sweden

Sweden generally uses a certification system

Except as noted below, Sweden uses a certification system to determine whether foreign persons receiving Swedish dividends, which are taxed at 30 percent, are entitled to treaty benefits. Sweden does not withhold tax on interest and royalty income earned by foreign persons. Under Sweden's system, a foreign person is required to obtain a certificate of residence from his or her tax authority or from a bank in his or her home country and present the certificate to the Swedish payor (usually a Swedish company).

Sweden uses a refund system for Swiss residents

For transactions covered under its tax treaty with Switzerland, Sweden uses a refund system. Thus, Swedish withholding agents withhold at the full 30 percent tax rate for dividend payments made to Swiss residents.

Source: Response received by IRS on December 7, 1982, from Sweden's Ministry of Budget.

Switzerland

Switzerland uses a refund system

Switzerland uses a refund system to grant treaty benefits for dividends and certain categories of interest, both of which are subject to a 35 percent withholding tax at source. Switzerland does not withhold tax on royalty income earned by foreign persons. A resident of a treaty partner who seeks treaty benefits has to file a refund claim. This claim is sent to the treaty country's tax authority, which has to certify that the claimant is a resident of that country and that the income in question is subject to tax.

Switzerland has a slightly different refund procedure for foreign investors who are U.S. residents. Rather than verify the U.S. resident's claim with IRS, Switzerland requires that the submitted refund claim be signed before a U.S. notary public who then forwards one copy of the claim to IRS. IRS uses the copy for its own tax administration and to ensure that the claimant was entitled to treaty benefits.

Switzerland provides certifications for its residents to Switzerland's treaty partners.

Source: Response dated December 8, 1982, to IRS from Switzerland's Federal Tax Administration, and Peat, Marwick, Main & Co.'s Taxation of Foreign Nationals in Europe.

Trinidad and Tobago

Trinidad and Tobago uses an address system

Trinidad and Tobago uses an address system to determine whether foreign persons are entitled to exemption from or reduced withholding in accordance with bilateral tax treaties. Except as noted below, Trinidad and Tobago uses the address system for dividends, interest, rents, and royalties. Along with the address, Trinidad and Tobago requires the following: (1) the type of income payment; (2) information on whether the income recipient is an individual or a company; and (3) the terms of the contract or agreement, if there is one, between the payor and the income recipient.

Trinidad and Tobago uses a certification system for certain interest income

Trinidad and Tobago uses a certification system for one type of interest income--interest paid to "Confirming Houses," such as financial institutions and brokerage houses. The certification is required at the time the Trinidad and Tobago payor makes the first payment. The certification is then kept so it can be referred to when subsequent payments are made. Trinidad and Tobago requires that the certification be provided by the treaty partner's tax authority. Trinidad and Tobago does not vary its certification requirements on a treaty-by-treaty basis.

Trinidad and Tobago provides certifications for its residents upon requests from other countries.

Source: Response dated February 24, 1983, to IRS from Trinidad and Tobago's Ministry of Finance.

Union of Soviet Socialist Republics

USSR uses an address system

The USSR uses an address system to determine whether foreign persons are eligible for exemption from or reduced withholding on interest and royalty income earned in the USSR. Under this system, the USSR's Ministry of Finance does not require any kind of certificate verifying residence in a treaty partner country. In its withholding decisions, however, the Ministry of Finance does consider any indirect evidence that a recipient is a resident of the country to which the income is being sent. An example of indirect evidence would be the fact that a company is registered as a corporation under the laws of the treaty partner country.

The USSR uses the address system to exempt or reduce taxes withheld at the source for payments relating to copyrights, licenses, and interest to foreign persons.

Source: Response dated February 16, 1983, to IRS from the Chief of the USSR's Department of State Revenue, Ministry of Finance.

The United Kingdom

The United Kingdom uses a certification system

The United Kingdom uses a certification system to determine whether foreign persons are legally entitled to an exemption from or reduction in withholding at the source for certain income in accordance with tax treaties. For dividend payments, the United Kingdom generally requires certifications only for the first payment. Under the United Kingdom-Switzerland treaty, certifications must be provided for every dividend payment.

The United Kingdom also requires certifications for interest and royalty income the first time the payments are made. The United Kingdom only requires updated or replacement certificates when material changes in the circumstances of the payment occur. Every five years, however, the foreign person is required to complete a questionnaire to verify the information.

The certifications required by the United Kingdom are to come from the treaty partners' tax authority. With the exception of the United States, certification should state that the foreign person is a resident of the treaty partner country for purposes of that country's tax. The forms submitted by U.S. residents state that the foreign person has filed a tax return as a citizen or resident of the United States.

The United Kingdom provides certifications to its treaty partners for residents of the United Kingdom.

The United Kingdom uses a refund system in special situations

The United Kingdom uses a refund-based withholding system for dividends from portfolio shareholding and other sources of income where relief from taxation at source is impractical. Also, the United Kingdom generally requires full withholding when payments are made to non-United Kingdom financial institutions.

Source: Text of United Kingdom's response obtained by GAO from IRS' Office of the Associate Chief Counsel (Technical and International); Peat, Marwick, Main & Co.'s Taxation of Foreign Nationals in Europe; and an August 24, 1987, letter to GAO from IRS' Assistant Commissioner (International).

West Germany

West Germany uses a certification system for royalties

West Germany uses a certification system to exempt from taxation royalty payments made to foreign persons. Royalty payments are subject to a 25 percent withholding tax at source. Generally, foreign persons requesting release from German tax must provide a certificate of residence every 3 years to West Germany's Federal Office of Finance. Except for U.S. citizens, the foreign person's tax authority must issue the certificate. West Germany allows U.S. residents to supply their own certifications as provided in an agreement between the two countries. U.S. residents also need to confirm that they filed U.S. tax returns. West Germany uses the same certification process for all countries with tax treaties, except for the United States.

West Germany provides certifications for its residents to all treaty partners.

West Germany uses a refund system for dividends and interest

West Germany uses a refund system for dividend and interest payments that are subject to a 25 percent withholding tax at source. In addition, West Germany uses the refund system for royalty payments when the German payor does not receive an exemption certificate and therefore withholds taxes when the royalty is paid.

West Germany uses an address system for small payments

West Germany uses a system similar to an address system for small income payments (individual payments of up to 4500.00 deutsche marks). Under this simplified procedure, German payors can decide whether tax treaty benefits should be granted to the foreign payee.

Source: Response dated February 24, 1983, to IRS from West Germany's, Federal Minister of Finance, and Peat, Marwick, Main & Co.'s Taxation of Foreign Nationals in Europe.

IRS Publication 686: Certification for Reduced Tax Rates in Tax Treaty Countries

Department of the Treasury
Internal Revenue Service

Publication 686
(Rev. Jan. 83)

Certification for Reduced Tax Rates in Tax Treaty Countries

Introduction

Most income tax treaties between the United States and foreign countries provide either a reduction in the statutory rate of tax or an exemption from tax on certain types of income received from sources within the foreign treaty country by citizens, domestic corporations, and residents of the United States.

Some treaty countries reduce the withholding tax on this income or exempt the income from withholding tax after the claimant furnishes evidence of eligibility for the benefits of the treaty.

Other countries initially withhold the tax at statutory rates and refund the excess tax withheld after satisfactory evidence of U.S. residence has been accepted.

As part of the proof of residence in the United States and of entitlement to the benefits of the treaty, the applicant must usually provide a U.S. Government certification that a U.S. income tax return was filed by the applicant as a citizen, domestic corporation, or resident of the United States. A return filed by an exempt organization is a "U.S. income tax return" for purposes of the certification.

Procedures for Certification

Most treaty countries that require certification provide special forms for that purpose. These forms contain questions to be answered by the taxpayer claiming treaty benefits, followed by a statement for the U.S. taxing authority's certification. This certification must be obtained from the office of the Director of the Service Center where the applicant's latest income tax return was filed.

Some forms are acceptable for certification by the Internal Revenue Service. Others are not acceptable without revision, because they request information that the Service cannot certify. In these instances, the office of the Director of the Service Center will prepare a document for certification.

Corporations. The Service Center Director will certify that the corporation filed a U.S. corporation income tax return as a domestic corporation for the tax year.

If a corporation or other like entity is new and has not yet filed an income tax return, a copy of the articles of incorporation or a written statement made under penalties of perjury by an authorized officer of the entity must be submitted, stating that the entity is organized in the United States, and that it has not yet been required to file an income tax return.

The Service Center Director can then certify that although the corporation or other entity has not filed a U.S. income tax return to date, the Service has in its possession documentary evidence that the corporation or entity will be treated as a U.S. corporation for U.S. income tax purposes and will, on the appropriate due date, be required to file a Form 1120, *U.S. Corporation Income Tax Return.* The Service Center will keep a permanent record of this documentation for any future reference.

Exempt organizations. In general, the same procedures that corporations follow to obtain certification should be used for any exempt organization wishing to show that it has filed a U.S. income tax return. This is true whether the organization filed a Form 1120 or whether it filed an exempt organization return.

Individuals. The Service Center Director will certify that the individual:

1) Filed for the tax year a U.S. income tax return required of a citizen or resident alien of the United States; *or*

2) Produced an immigrant identification card that is required of all aliens admitted for permanent residence in the United States.

Note: It is advantageous for individuals eligible to receive certification from the Internal Revenue Service to file a tax return even if they are ***not*** required to do so. The Service Center can then make the certification under normal procedures without the delay caused by correspondence with the individuals when no tax returns have been filed.

However, a delay could occur if certification is requested shortly after the tax return is filed, but before it is properly recorded. Under these circumstances, the Internal Revenue Service will request a copy of the latest return from the taxpayer, along with a written statement, made under the penalties of perjury, that the taxpayer was a resident of the United States for the period during which the treaty benefit is claimed.

A resident alien who has recently arrived in the United States and who has not yet filed an income tax return will normally be asked to get a statement from the Immigration and Naturalization Office, giving the alien's registration number, date and port of entry, date of birth, and classification.

Where to Get the Official Certification Forms

Official certification forms may be obtained from the foreign payer, the tax authority of the treaty country involved, or in some cases, from the Foreign Operations District, FOD:8, Internal Revenue Service, Washington, DC 20225.

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