

**EMBARGOED UNTIL DELIVERY**

*Remarks as Prepared for Delivery*

**Opening Statement of Manal Corwin  
Treasury Deputy Assistant Secretary (International Tax Affairs)  
Senate Committee on Foreign Relations  
June 7, 2011**

Chairman Kerry, Ranking Member Lugar, and distinguished Members of the Committee, I appreciate the opportunity to appear today to recommend, on behalf of the Administration, favorable action on three tax treaties pending before this Committee. We appreciate the Committee's interest in these treaties and in the U.S. tax treaty network overall.

This Administration is committed to eliminating barriers to cross-border trade and investment, and tax treaties are one of the primary means for eliminating such tax barriers. Tax treaties provide greater certainty to taxpayers regarding their potential liability to tax in foreign jurisdictions, and they allocate taxing rights between jurisdictions to reduce the risk of double taxation. Tax treaties also ensure that taxpayers are not subject to discriminatory taxation in foreign jurisdictions.

This Administration is also committed to preventing tax evasion, and our tax treaties play an important role in this area as well. A key element of U.S. tax treaties is exchange of information between tax authorities. Under tax treaties, one country may request from the other such information as may be relevant for the proper administration of the first country's tax laws. Because access to information from other countries is critically important to the full and fair enforcement of U.S. tax laws, information exchange is a top priority for the United States in its tax treaty program. Moreover, the United States has been a leader in the development of new international standards for greater transparency through full exchange of tax information.

A tax treaty reflects a balance of benefits that is agreed to when the treaty is negotiated. In some cases, changes in law or policy in one or both of the treaty partners make the partners more willing to increase the benefits beyond those provided in an existing treaty; in these cases, negotiation of revisions to a treaty may be very beneficial. In other cases, developments in one or both countries, or international developments more generally, may make it desirable to revisit an existing treaty to prevent improper exploitation of treaty provisions and eliminate unintended and inappropriate consequences in the application of the treaty. Both in setting our overall negotiation priorities and in negotiating individual treaties, our focus is on ensuring that our tax treaty network fulfills its goals of facilitating cross border trade and investment and preventing fiscal evasion.

The tax treaties before the Committee today with Hungary, Luxembourg and Switzerland, serve to further the goals of our tax treaty network. The tax treaty with Hungary would replace an existing treaty the revision of which has been a top tax treaty priority for the Treasury Department. The Protocols with Luxembourg and Switzerland

modify existing tax treaty relationships. We urge the Committee and the Senate to take prompt and favorable action on all of these agreements.

Before talking about the pending treaties in more detail, I would like to discuss some more general tax treaty matters.

### **Purposes and Benefits of Tax Treaties**

Tax treaties set out clear ground rules that govern tax matters relating to trade and investment between the two countries. One of the primary functions of tax treaties is to provide certainty to taxpayers regarding a threshold question with respect to international taxation: whether a taxpayer's cross-border activities will subject it to taxation by two or more countries. Tax treaties answer this question by establishing the minimum level of economic activity that must be conducted within a country by a resident of the other country before the first country may tax any resulting business profits. In general terms, tax treaties provide that if branch operations in a foreign country have sufficient substance and continuity, the country where those activities occur will have primary (but not exclusive) jurisdiction to tax. In other cases, where the operations in the foreign country are relatively minor, the home country retains the sole jurisdiction to tax.

Another primary function of tax treaties is relief of double taxation. Tax treaties protect taxpayers from potential double taxation primarily through the allocation of taxing rights between the two countries. This allocation takes several forms. First, because residence is relevant to jurisdiction to tax, a treaty has a mechanism for resolving the issue of residence in the case of a taxpayer that otherwise would be considered to be a resident of both countries. Second, with respect to each category of income, a treaty assigns primary taxing rights to one country, usually (but not always) the country in which the income arises (the "source" country), and the residual right to tax to the other country, usually (but not always) the country of residence of the taxpayer (the "residence" country). Third, a treaty provides rules for determining the country of source for each category of income. Fourth, a treaty establishes the obligation of the residence country to eliminate double taxation that otherwise would arise from the exercise of concurrent taxing jurisdiction by the two countries. Finally, a treaty provides for resolution of disputes between jurisdictions in a manner that avoids double taxation.

In addition to reducing potential double taxation, tax treaties also reduce potential "excessive" taxation by reducing withholding taxes that are imposed at source. Under U.S. law, payments to non-U.S. persons of dividends and royalties as well as certain payments of interest are subject to withholding tax equal to 30 percent of the gross amount paid. Most of our trading partners impose similar levels of withholding tax on these types of income. This tax is imposed on a gross, rather than net, amount. Because the withholding tax does not take into account expenses incurred in generating the income, the taxpayer that bears the burden of withholding tax frequently will be subject to an effective rate of tax that is significantly higher than the tax rate that would be applicable to net income in either the source or residence country. Tax treaties alleviate this burden by setting maximum levels for the withholding tax that the treaty partners

may impose on these types of income or by providing for exclusive residence-country taxation of such income through the elimination of source-country withholding tax. As a complement to these substantive rules regarding allocation of taxing rights, tax treaties provide a mechanism for dealing with disputes between countries regarding the proper application of a treaty. To resolve treaty disputes, designated tax authorities of the two governments – known as the “competent authorities” in tax treaty parlance – are required to consult and to endeavor to reach agreement. Under many such agreements, the competent authorities agree to allocate a taxpayer’s income between the two taxing jurisdictions on a consistent basis, thereby preventing the double taxation that might otherwise result. The U.S. competent authority under our tax treaties is the Secretary of the Treasury or his delegate. The Secretary of the Treasury has delegated this function to the Deputy Commissioner (International) of the Large Business and International Division of the Internal Revenue Service.

Tax treaties also include provisions intended to ensure that cross-border investors do not suffer discrimination in the application of the tax laws of the other country. This is similar to a basic investor protection provided in other types of agreements, but the non-discrimination provisions of tax treaties are specifically tailored to tax matters and, therefore, are the most effective means of addressing potential discrimination in the tax context. The relevant tax treaty provisions explicitly prohibit types of discriminatory measures that once were common in some tax systems, and clarify the manner in which possible discrimination is to be tested in the tax context.

In addition to these core provisions, tax treaties include provisions dealing with more specialized situations, such as rules addressing and coordinating the taxation of pensions, Social Security benefits, and alimony and child-support payments in the cross-border context (the Social Security Administration separately negotiates and administers bilateral totalization agreements). These provisions are becoming increasingly important as more individuals move between countries or otherwise are engaged in cross-border activities. While these matters may not involve substantial tax revenue from the perspective of the two governments, rules providing clear and appropriate treatment are very important to the affected taxpayers.

Tax treaties also include provisions related to tax administration. A key element of U.S. tax treaties is the provision addressing the exchange of information between the tax authorities. Under tax treaties, the competent authority of one country may request from the other competent authority such information as may be relevant for the proper administration of the first country’s tax laws (the information provided pursuant to the request is subject to the strict confidentiality protections that apply to taxpayer information). Because access to information from other countries is critically important to the full and fair enforcement of U.S. tax laws, information exchange is a priority for the United States in its tax treaty program. If a country has bank secrecy rules that would operate to prevent or seriously inhibit the appropriate exchange of information under a tax treaty, we will not enter into a new tax treaty relationship with that country. Indeed, the need for appropriate information exchange provisions is one of the treaty matters that we consider non-negotiable.

## **Tax Treaty Negotiating Priorities and Process**

The United States has a network of 60 income tax treaties covering 68 countries. This network covers the vast majority of foreign trade and investment of U.S. businesses and investors. In establishing our negotiating priorities, our primary objective is the conclusion of tax treaties that will provide the greatest benefit to the United States and to U.S. taxpayers. We communicate regularly with the U.S. business community and the Internal Revenue Service, seeking their input regarding the areas on which we should focus our treaty network expansion and improvement efforts and regarding practical problems encountered under particular treaties or particular tax regimes.

The primary constraint on the size of our tax treaty network may be the complexity of the negotiations themselves. Ensuring that the various functions to be performed by tax treaties are all properly taken into account makes the negotiation process exacting and time consuming.

Numerous features of a country's particular tax legislation and its interaction with U.S. domestic tax rules are considered in negotiating a tax treaty. Examples include whether the country eliminates double taxation through an exemption system or a credit system, the country's treatment of partnerships and other transparent entities, and how the country taxes contributions to, earnings of, and distributions from pension funds.

Moreover, a country's fundamental tax policy choices are reflected not only in its tax legislation but also in its tax treaty positions. These choices differ significantly from country to country, with substantial variation even across countries that seem to have quite similar economic profiles. A treaty negotiation must take into account all of these aspects of the particular treaty partner's tax system and treaty policies to arrive at an agreement that accomplishes the United States' tax treaty objectives.

Obtaining the agreement of our treaty partners on provisions of importance to the United States sometimes requires concessions on our part. Similarly, the other country sometimes must make concessions to obtain our agreement on matters that are critical to it. Each tax treaty that is presented to the Senate represents not only the best deal that we believe can be achieved with the particular country, but also constitutes an agreement that we believe is in the best interests of the United States.

In some situations, the right result may be no tax treaty at all. Prospective treaty partners must evidence a clear understanding of what their obligations would be under the treaty, especially those with respect to information exchange, and must demonstrate that they would be able to fulfill those obligations. Sometimes a tax treaty may not be appropriate because a potential treaty partner is unable to do so.

In other cases, a tax treaty may be inappropriate because the potential treaty partner is not willing to agree to particular treaty provisions that are needed to address real tax

problems that have been identified by U.S. businesses operating there. If the potential treaty partner is unwilling to provide meaningful benefits in a tax treaty, investors would find no relief, and accordingly there would be no merit to entering into such an agreement. The Treasury Department would not negotiate a tax treaty that did not provide meaningful benefits to U.S. investors or which could be construed by potential treaty partners as an indication that we would settle for a tax treaty with inferior terms.

Sometimes a potential treaty partner insists on provisions to which the United States will not agree, such as providing a U.S. tax credit for investment in the foreign country (so-called “tax sparing”). With other countries there simply may not be the type of cross-border tax issues that are best resolved by treaty. For example, if a country does not impose significant income taxes, there is little possibility of double taxation of cross-border income, and an agreement that focuses exclusively on the exchange of tax information (so-called “tax information exchange agreements” or “TIEAs”) may be the more appropriate agreement.

### **Ensuring Safeguards against Abuse of Tax Treaties**

A high priority for improving our overall treaty network is continued focus on prevention of “treaty shopping.” The U.S. commitment to including comprehensive “limitation on benefits” provisions is one of the keys to improving our overall treaty network. Our tax treaties are intended to provide benefits to residents of the United States and residents of the particular treaty partner on a reciprocal basis. The reductions in source-country taxes agreed to in a particular treaty mean that U.S. persons pay less tax to that country on income from their investments there and residents of that country pay less U.S. tax on income from their investments in the United States. Those reductions and benefits are not intended to flow to residents of a third country. If third-country residents are able to exploit one of our tax treaties to secure reductions in U.S. tax, such as through the use of an entity resident in a treaty country that merely holds passive U.S. assets, the benefits would flow only in one direction, as third-country residents would enjoy U.S. tax reductions for their U.S. investments, but U.S. residents would not enjoy reciprocal tax reductions for their investments in that third country. Moreover, such third-country residents may be securing benefits that are not appropriate in the context of the interaction between their home country’s tax systems and policies and those of the United States. This use of tax treaties is not consistent with the balance of the deal negotiated in the underlying tax treaty. Preventing this exploitation of our tax treaties is critical to ensuring that the third country will sit down at the table with us to negotiate on a reciprocal basis, so we can secure for U.S. persons the benefits of reductions in source-country tax on their investments in that country. Effective anti-treaty shopping rules also ensure that the benefits of a U.S. tax treaty are not enjoyed by residents of countries with which the United States does not have a bilateral tax treaty because that country imposes little or no tax, and thus the potential of unrelieved double taxation is low.

In this regard, the proposed tax treaty with Hungary that is before the Committee today includes a comprehensive limitation on benefits provision and represents a major step forward in protecting the U.S. tax treaty network from abuse. As was discussed in the

Treasury Department's 2007 Report to the Congress on Earnings Stripping, Transfer Pricing and U.S. Income Tax Treaties, the existing income tax treaty with Hungary, which was signed in 1979, is one of three U.S. tax treaties that, as of 2007, provided an exemption from source-country withholding on interest payments, but contained no protections against treaty shopping. The other two agreements in this category were the 1975 tax treaty with Iceland and the 1974 tax treaty with Poland. The revision of these three agreements has been a top priority for the Treasury Department's treaty program, and we have made significant progress. In 2007, we signed a new tax treaty with Iceland which entered into force in 2008. Like the proposed tax treaty with Hungary, the U.S.-Iceland tax treaty contains a comprehensive limitation on benefits provision. In addition, the Treasury Department has recently concluded negotiations of a new income tax treaty with Poland, which the Administration hopes to sign and transmit to the Senate for its advice and consent soon. These achievements demonstrate that the Treasury Department has been effective in addressing concerns about treaty shopping through bilateral negotiations and amendment of our existing tax treaties.

### **Combating Tax Evasion and Improving Transparency through Full Exchange of Information**

As noted above, effective information exchange to combat tax evasion and ensure full and fair enforcement of the law is a top priority for the United States. The United States has been a leader in developing and promoting global adoption of the international standards for information exchange. A key element of U.S. income tax treaties is to provide for the exchange of information between tax authorities where the economic relationship between two countries is such that an income tax treaty is appropriate. Where an income tax treaty is not appropriate, information exchange can be secured through a tax information exchange agreement (a "TIEA") which contains provisions exclusively on sharing of tax information. For example, the Administration was pleased to sign last November a TIEA with Panama that follows international standards, and which entered into force this past April.

The proposed Protocols with Switzerland and Luxembourg that are before the Committee today revise the existing tax treaties with Switzerland and Luxembourg to ensure full exchange of information to prevent tax evasion and enhance transparency. These Protocols incorporate the current international standards for exchange of information, which require countries to obtain and exchange information for both civil and criminal matters, and which require the tax authorities to obtain and exchange information that is held by a bank or other financial institution.

### **Consideration of Arbitration**

Tax treaties cannot facilitate cross-border investment and provide a more stable investment environment unless the treaty is effectively implemented by the respective tax administrations of the two countries. Under our tax treaties, when a U.S. taxpayer becomes concerned about implementation of the treaty, the taxpayer can bring the matter to the U.S. competent authority who will seek to resolve the matter with the competent

authority of the treaty partner. The competent authorities are expected to work cooperatively to resolve genuine disputes as to the appropriate application of the treaty.

The U.S. competent authority has a good track record in resolving disputes. Even in the most cooperative bilateral relationships, however, there may be instances in which the competent authorities will not be able to reach a timely and satisfactory resolution. Moreover, as the number and complexity of cross-border transactions increases, so do the number and complexity of cross-border tax disputes. Accordingly, we have considered ways to equip the U.S. competent authority with additional tools to assist in resolving disputes promptly, including the possible use of arbitration in the competent authority mutual agreement process.

The first U.S. tax agreement that contemplated arbitration was the U.S.-Germany income tax treaty signed in 1989. Tax treaties with some other countries, including Mexico and the Netherlands, incorporate authority for establishing voluntary binding arbitration procedures based on the provision in the prior U.S.-Germany treaty (although these provisions have not been implemented). Although we believe that the presence of such voluntary arbitration provisions may have provided some limited incentive to reaching more expeditious mutual agreements, it has become clear that providing the mere ability to enter into voluntary arbitration is not nearly as effective as providing for mandatory arbitration, under certain circumstances, within the treaty itself.

Over the past few years, we have carefully considered and studied various types of mandatory arbitration procedures that could be included in our treaties and used as part of the competent authority mutual agreement process. In particular, we examined the experience of countries that adopted mandatory binding arbitration provisions with respect to tax matters. Many of them report that the prospect of impending mandatory arbitration creates a significant incentive to compromise before commencement of the arbitration process. Based on our review of the U.S. experience with arbitration in other areas of the law, the success of other countries with arbitration in the tax area, and the overwhelming support of the business community, we concluded that mandatory binding arbitration as the final step in the competent authority process can be an effective and appropriate tool to facilitate mutual agreement under U.S. tax treaties.

One of the treaties before the Committee, the proposed Protocol with Switzerland, includes a type of mandatory arbitration provision that in general terms is similar to arbitration provisions in several of our recent treaties (Canada, Germany, Belgium and France) that have been approved by the Committee and the Senate over the last five years.

In the typical competent authority mutual agreement process, a U.S. taxpayer presents its case to the U.S. competent authority and participates in formulating the position the U.S. competent authority will take in discussions with the treaty partner. Under the arbitration provision proposed in the Switzerland protocol, as in the similar provisions that are now part of our treaties with Canada, Germany, Belgium and France, if the competent authorities cannot resolve the issue within two years, the competent authorities must

present the issue to an arbitration board for resolution, unless both competent authorities agree that the case is not suitable for arbitration. The arbitration board must resolve the issue by choosing the position of one of the competent authorities. That position is adopted as the agreement of the competent authorities and is treated like any other mutual agreement (*i.e.*, one that has been negotiated by the competent authorities) under the treaty.

The arbitration process proposed in the agreement with Switzerland is mandatory and binding with respect to the competent authorities. However, consistent with the negotiation process under the mutual agreement procedure generally, the taxpayer can terminate the arbitration at any time by withdrawing its request for competent authority assistance. Moreover, the taxpayer retains the right to litigate the matter (in the United States or the treaty partner) in lieu of accepting the result of the arbitration, just as it would be entitled to litigate in lieu of accepting the result of a negotiation under the mutual agreement procedure.

The arbitration rule in the proposed Protocol with Switzerland is very similar to the arbitration rule in the Protocol with France, but differs slightly from the arbitration rules in the agreements with Canada, Germany and Belgium. This is because in negotiating the arbitration rule in the Protocol with France, we took into account concerns expressed by this Committee over certain aspects of the arbitration rules negotiated earlier with Canada, Germany and Belgium. Accordingly, the proposed arbitration rule with Switzerland, like the provision with France, differs from its earlier predecessors in three key respects. First, consistent with the Committee's comment in its report on the Canada protocol that future arbitration rules should provide a mechanism for taxpayer input in the arbitration process, the proposed rules with Switzerland allow the taxpayers who presented the original case that is subjected to arbitration to submit a position paper directly to the arbitration panel. Second, the rule in the proposed Switzerland Protocol disallows a competent authority from appointing an employee from its own tax administration to the arbitration board. Finally, the rule in the proposed Switzerland Protocol does not prescribe a hierarchy of legal authorities that the arbitration panel must use in making its decision. Thus, customary international law rules on treaty interpretation will apply. Currently, we are discussing the possible inclusion of a similar arbitration provision with a number of our other key tax treaty partners.

Because the arbitration board can only choose between the positions of each competent authority, the expectation is that the differences between the positions of the competent authorities will tend to narrow as the case moves closer to arbitration. In fact, if the arbitration provision is successful, difficult issues will be resolved without resort to arbitration. Thus, it is our objective that these arbitration provisions will be rarely utilized, but that their presence will encourage the competent authorities to take approaches to their negotiations that result in mutually agreeable conclusions without invoking the arbitration process.

It is still very early in our experience with arbitration, and at this time we cannot report definitively on the effects of arbitration on our tax treaty relationships. However, we are

hopeful that our desired objectives for arbitration are being realized. Our sense is that, where mandatory arbitration has been included in the treaty, the competent authorities are negotiating with more intention to reach principled and timely resolution of disputes, and thus, effectively eliminating double taxation and in a more expeditious manner.

Arbitration is a growing and developing field, and there are many forms of arbitration from which to choose. We intend to continue to study other arbitration provisions and to monitor the performance of the provisions in the agreements with Canada, Belgium, Germany and France, as well as the performance of the provision in the agreement with Switzerland, if ratified. The Internal Revenue Service has published the administrative procedures necessary to implement the arbitration rules with Germany Belgium and Canada. It is possible that one or more tax disputes with Canada will be submitted for resolution by arbitration, and the Administration looks forward to updating the Committee on the arbitration process, in particular through the reports that are called for in the Committee's reports on 2007 Protocol to the Canada tax treaty. We look forward to continuing to work with the Committee to make arbitration an effective tool in promoting the fair and expeditious resolution of treaty disputes.

### **Discussion of Proposed Treaties**

I now would like to discuss the three tax treaties that have been transmitted for the Senate's consideration. The three treaties are generally consistent with modern U.S. tax treaty practice as reflected in the Treasury Department's 2006 U.S. Model Income Tax Convention. As with all bilateral tax conventions, the treaties contain some minor variations that reflect particular aspects of the treaty policies and domestic laws of the partner countries as well as their economic relations with the United States. We have submitted a Technical Explanation of each treaty that contains detailed discussions of the provisions of each treaty. These Technical Explanations serve as the Treasury Department's official explanation of each tax treaty.

#### *Hungary*

The proposed income tax Convention and related agreement effected by exchange of notes with Hungary were negotiated to bring tax treaty relations based on the current Convention, signed in 1979, into closer conformity with current U.S. tax treaty policy. The proposed Convention contains a comprehensive "Limitation on Benefits" article designed to address treaty shopping. The current Convention does not contain treaty shopping protections and, as a result, has been used inappropriately by third-country investors in recent years. For this reason, as stated above, entering into a revised Convention has been a top tax treaty priority for the Treasury Department. The new Limitation on Benefits article includes a provision granting so-called "derivative benefits" similar to the provision included in all recent U.S. tax treaties with countries that are members of the European Union. The new Limitation on Benefits article also contains a special rule for so-called "headquarters companies" that is identical to what the Treasury has agreed to with a number of other tax treaty partners.

The proposed Convention incorporates updated rules that provide that a former citizen or long-term resident of the United States may, for the period of ten years following the loss of such status, be taxed in accordance with the laws of the United States. The proposed Treaty also coordinates the U.S. and Hungarian tax rules to address the “mark-to-market” provisions enacted by the United States in 2007 that apply to individuals who relinquish U.S. citizenship or terminate long-term residency.

The withholding rates on investment income in the proposed Convention are the same as or lower than those in the current treaty. The proposed Convention provides for reduced source-country taxation of dividends distributed by a company resident in one Contracting State to a resident of the other Contracting State. The proposed Convention generally allows for taxation at source of five percent on direct dividends (i.e., where a 10-percent ownership threshold is met) and 15 percent on all other dividends. Additionally, the proposed Convention provides for an exemption from withholding tax on certain cross-border dividend payments to pension funds.

The proposed Convention updates the treatment of dividends paid by U.S. Regulated Investment Companies (RICs) and Real Estate Investment Trusts (REITs) to prevent the use of structures designed to inappropriately avoid U.S. tax.

Consistent with the current treaty, the proposed Convention generally eliminates source-country withholding taxes on cross-border interest and royalty payments. However, consistent with current U.S. tax treaty policy, source-country tax may be imposed on certain contingent interest and payments from a U.S. real estate mortgage investment conduit.

The taxation of capital gains under the proposed Convention generally follows the format of the U.S. Model. Gains derived from the sale of real property and from real property interests may be taxed by the State in which the property is located. Likewise, gains from the sale of personal property forming part of a permanent establishment situated in a Contracting State may be taxed in that State. All other gains, including gains from the alienation of ships, boats, aircraft and containers used in international traffic and gains from the sale of stock in a corporation, are taxable only in the State of residence of the seller.

The proposed Convention, like several recent tax treaties, provides that the OECD Transfer Pricing Guidelines apply by analogy in determining the amount of business profits of a resident of the other country. The source country's right to tax such profits is generally limited to cases in which the profits are attributable to a permanent establishment located in that country. The proposed Convention generally defines a “permanent establishment” in a way that grants rights to tax business profits that are consistent with those found in the U.S. Model.

The proposed Convention preserves the U.S. right to impose its branch profits tax on U.S. branches of Hungarian corporations. The proposed Convention also accommodates a provision of U.S. domestic law that attributes to a permanent establishment income that is

earned during the life of the permanent establishment, but is deferred, and not received until after the permanent establishment no longer exists.

The proposed Convention would change the rules currently applied under the existing Convention regarding the taxation of independent personal services. Under the proposed treaty an enterprise performing services in the other country will become taxable in the other country only if the enterprise has a fixed place of business in that country.

The rules for the taxation of income from employment under the proposed Convention are generally similar to those under the U.S. Model. The general rule is that employment income may be taxed in the State where the employment is exercised unless three conditions constituting a safe harbor are satisfied.

The proposed Convention preserves the current Convention's rules that allow for exclusive residence-country taxation of pensions, and consistent with current U.S. tax treaty policy, provides for exclusive source-country taxation of Social Security payments.

Consistent with the OECD standard, the proposed Convention provides for the exchange between the tax authorities of each country of information relevant to carrying out the provisions of the proposed Convention or the domestic tax laws of either country. The proposed Convention allows the United States to obtain information (including from financial institutions) from Hungary whether or not Hungary needs the information for its own tax purposes.

The proposed Convention would enter into force on the date of the exchange of instruments of ratification. It would have effect, with respect to taxes withheld at source, for amounts paid or credited on or after the first day of the second month next following the date of entry into force, and with respect to other taxes, for taxable years beginning on or after the first day of January next following the date of entry into force. The current Convention will, with respect to any tax, cease to have effect as of the date on which this proposed Convention has effect with respect to such tax.

### *Luxembourg*

The proposed Protocol to amend the income tax Convention with Luxembourg and the related agreement effected by exchange of notes were negotiated to bring the existing Convention, signed in 1996, into closer conformity with current U.S. tax treaty policy regarding exchange of information.

The proposed Protocol replaces the existing Convention's tax information exchange provisions with updated rules that are consistent with current U.S. tax treaty practice and the standards for exchange of information developed by the OECD. The proposed Protocol allows the tax authorities of each country to exchange information that is foreseeably relevant to carrying out the provisions of the agreement or the domestic tax laws of either country. Among other things, the proposed Protocol would allow the United States to obtain information from Luxembourg whether or not Luxembourg needs

the information for its own tax purposes, and provides that requests for information cannot be declined solely because the information is held by a bank or other financial institution. The proposed related agreement effected by exchange of notes sets forth agreed understandings between the parties regarding the updated provisions on tax information exchange, and includes obligations on the United States and Luxembourg to ensure that their respective competent authorities have the authority to obtain and provide upon request information held by banks and other financial institutions and information regarding ownership of certain entities; and information shall be exchanged without regard to whether the conduct being investigated would be a crime under the laws of the requested State.

The proposed Protocol would enter into force once both the United States and Luxembourg have notified each other that their respective applicable procedures for ratification have been satisfied. It would have effect with respect to requests made on or after the date of entry into force with regard to tax years beginning on or after January 1, 2009. The related agreement effected by exchange of notes would enter into force on the date of entry into force of the proposed Protocol and would become an integral part of the Convention on that date.

#### *Switzerland*

The proposed Protocol to amend the income tax convention with the Swiss Confederation and related agreement effected by exchange of notes were negotiated to bring the existing Convention, signed in 1996, into closer conformity with current U.S. tax treaty policy regarding exchange of information. There are, as with all bilateral tax conventions, some variations from these norms. In the proposed Protocol, these minor differences reflect particular aspects of Swiss law and treaty policy, and generally follow the OECD standard for exchange of information.

The proposed Protocol replaces the existing Convention's tax information exchange provisions with updated rules that are consistent with current U.S. tax treaty practice and the standards for exchange of information developed by the OECD. The proposed Protocol allows the tax authorities of each country to exchange information that may be relevant to carrying out the provisions of the agreement or the domestic tax laws of either country, including information that would otherwise be protected by the bank secrecy laws of either country. The proposed Protocol would allow the United States to obtain information from Switzerland whether or not Switzerland needs the information for its own tax purposes, and provides that requests for information cannot be declined solely because the information is held by a bank or other financial institution.

The proposed Protocol amends a paragraph of the existing protocol to the existing Convention by incorporating procedural rules to govern requests for information and an agreement by the United States and Switzerland that such procedural rules are to be interpreted in order not to frustrate effective exchange of information.

The proposed Protocol and related agreement effected by exchange of notes update the provisions of the existing Convention with respect to the mutual agreement procedure by

incorporating mandatory arbitration of certain cases that the competent authorities of the United States and the Swiss Confederation have been unable to resolve after a reasonable period of time.

Finally, the proposed Protocol updates the provisions of the existing Convention to provide that individual retirement accounts are eligible for the benefits afforded a pension under the existing Convention.

The proposed Protocol would enter into force when the United States and the Swiss Confederation exchange instruments of ratification. The proposed Protocol would have effect, with respect to taxes withheld at source, for amounts paid or credited on or after the first day of January of the year following entry into force. With respect to tax information exchange, the proposed Protocol would have effect with respect to requests for bank information that relates to any date beginning on or after the date the proposed Protocol is signed and, with respect to all other cases, would have effect with respect to requests for information that relates to taxable periods beginning on or after the first day of January next following the date of signature. The mandatory arbitration provision would have effect with respect both to cases that are under consideration by the competent authorities as of the date on which the Protocol enters into force and to cases that come under consideration after that date.

### **Treaty Program Priorities**

A key continuing priority for the Treasury Department is updating the few remaining U.S. tax treaties that provide for significant withholding tax reductions but do not include the limitation on benefits provisions needed to protect against the possibility of treaty shopping. As mentioned above, I am pleased to report that in this regard we have made significant progress. Most notably, in June 2010 we concluded the negotiation of a new tax treaty with Poland. The new Poland treaty, which we hope to sign soon, will contain a comprehensive limitation on benefits provision that will ensure that only residents of the United State and Poland enjoy the benefits of the treaty.

Concluding agreements that provide for the full exchange of information, including information held by banks and other financial institutions, is another key priority of the Treasury Department. The past couple of years have been a period of fundamental change in transparency, as many secrecy jurisdictions announced their intentions to comply with the international standard of full information exchange during this time. With the revisions to the Switzerland and Luxembourg tax treaties completed, in the near future we hope to commence or renew tax treaty negotiations with a number of our other trading partners with bank secrecy rules once those countries have eliminated all domestic law impediments to full exchange of information.

Beyond the two chief priorities of curbing treaty shopping and expanding exchange of information relationships, the Treasury Department continues to maintain a very active calendar of tax treaty negotiations. In our efforts to establish new tax treaty relationships, in February 2010 we signed a tax treaty with Chile, which the Administration hopes to

transmit to the Senate for its consideration in the near term. If approved by the Senate the Chile tax treaty would be especially noteworthy because it would be only the second U.S. tax treaty in force with a South American country. We have also opened tax treaty negotiations with Vietnam. Additionally, we are in the process of discussing ways to update existing tax treaties with many of our treaty partners including the United Kingdom and Spain.

### **Conclusion**

Mr. Chairman and Ranking Member Lugar, let me conclude by thanking you for the opportunity to appear before the Committee to discuss the Administration's efforts with respect to the three agreements under consideration. We appreciate the Committee's continuing interest in the tax treaty program, and we thank the Members and staff for devoting time and attention to the review of these new agreements. We are also grateful for the assistance and cooperation of the staff of the Joint Committee on Taxation.

On behalf of the Administration, we urge the Committee to take prompt and favorable action on the agreements before you today. I would be happy to respond to any question you may have.