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TAXATION OF INTERNATIONAL TRANSPORTATION COMPANIES' INCOME IN THE UNITED STATES

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ÖZET : Bu makalede Amerika Birleşik Devletleri'nde uluslararası taşımacılık faaliyetlerinden elde edilen gelirlerin vergilendirilmesi, mevzuatta yapılan değişikliklerin ışığı altında incelenmiştir. Taraf olunan çifte vergilendirmeyi önleme anlaşmalarında taşımacılık gelirlerinin ne şekilde vergilendirildiği ve kendilerince meydana getirilen modelin diğer modellerden farkları ele alınarak, uygulamada ne tür sorunlar olduğu, bazı çözüm önerileriyle birlikte ortaya konmuştur.

1- INTRODUCTION

In the United States, the Internal Revenue Code of 1986 replaced the Internal Revenue Code of 1954. The changes made in the later Code are especially important for foreign corporations operating in international traffic. With the 1986 Tax Reform, the reduction of applicable reciprocal exemptions are based on residence instead of flag or documentation of vessel, 4 per cent gross basis tax is imposed for international transportation companies and 50 per cent source rule for transportation that begins or ends in the United States is imposed. Since the existing system before 1986 was easily manipulated by transport companies the new system has increased the United States' income from international transportation.

When dealing with international business, taxation is one of the most important problems. Double taxation, which is to tax the same profit by two or more countries, is a serious obstacle that confronts international enterprises. Inevitably international transportation business also has double taxation problem due to its nature, because international transportation companies work in international arena.

II- THE UNITED STATES DOUBLE TAXATION TREATIES

The first international tax treaties concerning double taxation appeared in the United States in the late nineteenth and early twentieth centuries. The United States had given unilateral double taxation relief to its citizens and residents by providing a tax credit deduction from 1918[1].

The 1928 models issued in Geneva by the League of Nations served as a framework for the earliest United States tax treaties[2]. The first general tax treaty -after certain limited treaties about taxation of shipping profits - was with France on 27.4.1932[3] and concerned income from government service, war pensions, private pensions and annuities, royalties and business profits. The next was concluded with Canada in 1936[4].

The treaty that was signed by the United States with Sweden in 1939[5] for the prevention of double taxation was broader than the United States-France treaty[6]. It was the United States' first comprehensive international treaty to prevent or mitigate double taxation of income[7]. Another treaty was signed in 1939 with France[8] but was not ratified until the end of the Second World War.

The United States signed a general treaty with Canada in 1942 concerning double taxation and administrative co-operation[9].Transportation income was taxed on the residence principle as stated in Article V:

"*Income which an enterprise of one of the contracting states has from the operation of ships or aircraft registered in that state shall be exempt from taxation in the other contracting state.*".

Between 1945 and 1958, the United States signed many Treaties[10]. In 1955, the Netherlands treaty was extended to an overseas territory of a treaty partner, the Netherlands Antilles[11]. In 1957, the Belgian treaty was extended to three Belgian territories that are now Rwanda, Burundi and Zaire[12]. In 1958, the United Kingdom treaty was extended to 20 overseas territories of the United Kingdom[13].

The United States signed further sixteen treaties until publication of the United States Model Treaty in 1976[14].

On 18.5.1976, the first United States Model Income Tax Treaty was published by the Treasury

Department[15]. In the next year a revised Model was published[16], which the Treasury Department suggested as the starting point for negotiations[17]. On 16 June 1981 a third Model, the Proposed Model Income Tax Treaty, was published by the United States Treasury Department[18].

An alternative draft of Article 16 (treaty shopping) of the third Model was published on 23.12.1981[19]. In practice, the latter Model was served as the US Model Treaty[20]. The United States Treasury was planning to publish a revised Model Treaty with a technical explanation[21] and on 20.9.1996 the United States Model Income Tax Convention[22]is published[23].

The United States tax treaties come into force after the advice and consent of the United States Senate, approval by the President of the United States and the exchange of instruments of ratification[24].

The United States adopts residence principle for international shipping and air transportation under its own model treaty [25]. Article 8, which concerns shipping and air transport like the OECD and the United Nations Models, is as follows:

1- Profits of an enterprise of a Contracting State[26] *from the operation of ships or aircraft in international traffic shall be taxable only in that State.*

2- For the purposes of this Article, profits from the operation of ships or aircraft include profits derived from the rental of ships or aircraft on a full (time or voyage) basis. They also include profits from the rental of ships or aircraft on a bareboat basis if such ships or aircraft are operated in in international traffic by the lessee, or if the rental income is incidental to profits from the operation of ships or aircraft in international traffic. Profits derived by an enterprise from the inland transport of property or passengers within either Contracting State, shall be treated as profits from the operation of ships or aircraft in international traffic if such transport is undertaken as part of international traffic.

3- Profits of an enterprise of a Contracting State from the use, maintenance, or rental of containers (including trailers, barges, and related equipment for the transport of containers) used in international traffic shall be taxable only in that State.

4- The provisions of paragraphs 1 and 3 shall also apply to profits from participation in a pool, a joint business, or an international operating agency.

There are differences and similarities between the United States Model and the OECD Model[27]:

1- The residence principle is used in paragraph 1 of Article 8 of the United States Model regarding profits from the operation of ships or aircraft in international traffic in contrast to the place of effective management principle in the OECD Model Article 8 and the United Nations Model Article 8A and Article 8B (only for air transportation).

2- In the matter of double taxation the United States Model applies the credit method, but the OECD Model uses the exemption and credit method.

3- United States Model Convention Article 8 is extended to cover bareboat charters[28], in contrast to the OECD and United Nations Model treaties.

4- For the purposes of Article 8, the income from the rental of ships, aircraft and containers is essentially similar to income from international shipping and air transport[29].

The residence principle has been used, for example, in double taxation agreements with Austria[30], Czech Republic[31], Denmark[32], Finland[33], France[34], Germany[35], Hungary[36], Italy[37], Luxembourg[38], Portugal[39], Russia[40], Spain[41], Sweden[42] and Switzerland[43].

The definition of "international traffic" in the 1996 United States Model Treaty is the same as in the 1977 and 1981 United States Model Treaties[44]. However, Article 8 had been subject to two changes between the 1977 and 1981. The 1981 Model omitted "*on a full or bareboat basis*" in paragraph 1 and "*...for transport...*" from the phrase "*...containers...used for transport in international commerce...*" in paragraph 3.

Some double taxation agreements can be given as an example for the determination of transportation. For example, under the United States - Netherlands tax treaty[45], some activities are within the context of the operation of ships. Both countries agreed on following words[46]:

"In view of the fact that shipping companies are utilising the container method of ocean transportation, certain ancillary activities connected with container transportation would be included within the provision applicable to the operation of ships in international traffic."

However, for the United States Internal Revenue any gain from the disposition of any United States real property is not treated as income from the international operation of ships and aircraft[47].

Under United States - Germany double taxation agreement[48] both states agreed to interpret the term "operation of ships" in the same manner as under United States - Netherlands tax treaty.

In a dispute between the United States and Australia[49], an Australian registered corporation engaged in international air transportation sold many of its obsolete aircraft, spare engines and spare parts that were used in the company's business, within the United States. The question was whether the income from the sales of this equipment was to be subject to United States income tax[50].

Under Article V(1), of the United States - Australia Tax Convention, profit derived by an Australian resident from operating ships or aircraft registered in Australia shall be exempt from United States Federal Income Tax.

Also under Article II(2), "...in the application of the provisions of the Convention by one of the Contracting States any term, not otherwise defined shall, unless the context otherwise requires, have the meaning that it has under the laws of that State relating to the taxes that are the subject of the Convention."

The Revenue Ruling stated, after examining the related sections of Internal Revenue Code of 1954[51] that the income from the sales of obsolete aircraft, spare engines and spare parts in the United States was within the context of Article V(1) of the United States - Australia Tax Convention, and was therefore exempt from United States Federal Income Tax. The Revenue Ruling also mentioned that the sales occurred because of technological necessity rather than the liquidation of the business[52]. Otherwise, the income would not be within the context of operation of ships or aircraft.

About residency, the United States Model Article 4 has some differences in contrast to the OECD and the United Nations Models. It states that:

"1- Except as provided in this paragraph, for the purposes of this Convention, the term 'resident of a Contracting State' means any person, who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature.

a- this term does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein; and

b- A legal person organized under the laws of a Contracting State and that is generally exempt from tax in that State and is established and maintained in that State either:

i- exclusively for a religious, chatitable, educational, scientific, or other similar purpose; or

ii- to provide pensions or other similar benefits to employees pursuant to a plan is to be treated for purposes of this paragraph as a resident of that Contracting State.

c- A qualified governmental entity is to be treated as a resident of the Contracting State where it is established.

d- An item of income, profit or gain derived through an entity that is fiscally transparent under the laws of either Contracting State shall be considered to be derived by a resident of a State to the extent that the item is treated for purposes of the taxation law of such Contracting State as the income, profit or gain of a resident.

...

3- Where by reason of the provisions of paragraph 1 a company is a resident of both Contracting States, then if it is created under the laws of a Contracting States or a political subdivision thereof, it shall be deemed to be a resident of that State.

4- Where by reason of the provisions of paragraph 1 a person other than an individual or a company is a resident of both Contracting States, the competent authorities of the Contracting States shall settle the question by mutual agreement and determine the mode of application of the Convention to such person."

In the United States Model the citizenship and the place of incorporation are added to the criteria placed in the first paragraph.

The third paragraph of the United States Model is related to dual residency. If the company is dual resident, the place of incorporation will be company's residence. If dual residency exists for a person other than an individual or a company, the competent authorities of the contracting states will solve the problem.

The United States applies only to the "incorporation" test. A company is non-resident if its place of incorporation is outside the United States. The existence of, for example, the place of effective

management does not establish residency for a foreign company in the United States.

In *Taisei Fire and Marine Insurance Co. Ltd. et al. v. Commissioner*[53], the question was whether the existence of an agent is sufficient for four Japanese companies to be deemed to have a permanent establishment. The Tax Court checked all the facts and circumstances and found that the agent had no legal and economic dependence on the principal, therefore, permanent establishment did not exist for the foreign enterprise[54].

For the existence of legal dependence, the court reviewed the actual control of the foreign principal on the agent, contractual arrangements and control over the business practices between them, the agent's administrative structure which led the court to decide that the agent was independent.

Also, there was no guarantees of profits or stop-loss arrangements between the parties and the principals could terminate the relationship with reasonable notice which was found sufficient by the court to established that, there was no economic dependence[55].

In *De Amodio v. Commissioner*[56], the United States Tax Court found that a non-resident was not carrying on a trade or business in the United States despite the fact that he had received business income from rental property in the United States which has been run by an independent company hired by the non-resident.

2- Taxation of International Transportation Companies' Income

1986 was a very important year for the tax system applicable to foreign transportation companies in the United States[57]. The Internal Revenue Code of 1986 was enacted by 1986 Tax Reform Act to replace the Internal Revenue Code of 1954, which needed many changes by virtue of the development of international tax law.

The Tax Reform Act 1986 changed the taxation of foreign corporations which operate vessels or aircraft in international traffic[58]. The main changes in the field of international transportation were as follows[59]:

a- The imposition of a 4% gross basis tax.

b- Reciprocal exemption to be based on "residence" instead of flag or documentation of vessel.

c- The imposition of a 50% source rule for transportation which begins or ends in the United States

a- 4% Gross Basis Tax

In 1986 the United States Congress imposed a 4% gross basis tax[60] on non-resident foreign individuals' and corporations' United States source gross transportation income without deductions[61].

However, when a non-resident corporation maintains a trade or business within the United States during a taxable year in which it is effectively connected[62] with the United States, its income is subject to the regular corporate tax rate of up to 35%, after allowable deductions.

The Internal Revenue Code imposes two requirements, which apply together, to determine whether non-resident transportation corporations' income is effectively connected with the conduct of a trade or business in the United States:

a- If the taxpayer has a fixed place of business in the United States to earn transportation income, its United States source gross transportation income is considered effectively connected transportation income.

b- If substantially all[63] of the taxpayer's United States source gross transportation income derives from regularly scheduled transportation, which is not defined in the Income Tax Act, this income is effectively connected transportation income[64].

When a foreign corporation fails either of these tests, its income will be subject to 4% gross basis tax. It is not important whether the company makes a profit or not.

The important point here is that although the Internal Revenue Code Section 887(b)(4)(a) refers to only a "*If the taxpayer has a fixed place of business in the United States to earn transportation income, its United States source gross transportation income is considered effectively connected transportation income.*", the Internal Revenue Code section 864(c)(4)(B) states "*Income, gain or loss from sources without the United States shall be treated as effectively connected with the conduct of trade or business within the United States by a non-resident alien individual or a foreign corporation if such person has an office or other fixed place of business within the United States ...*". In this context, United States source transportation income is not limited by being attributable to a fixed place of business but also includes income attributable to an office.

Regularly scheduled transportation occurs when a ship or aircraft follows a published schedule with repeated sailings or flights, as the case may be, at regular intervals between the same points for voyages or flights which begin or end in the United States[65].

Air transportation, in this context, includes both scheduled and chartered air carriers. On the other hand, tramp shipping that has no fixed route, no regular time of sailing and travels from port to port in search of cargo to transport is not within the concept of the term "regularly scheduled transportation"[66].

The leasing income of vessel or aircraft will not be treated as effectively connected with the conduct of trade or business within the United States, unless[67]:

a- The foreign person maintains a fixed place of business in the United States involved in the earning of United States source gross transportation income; and

b- Substantially all of the person's United States source gross transportation income from leasing is attributable to that fixed place of business.

The term "leasing income" here includes income from the bareboat charter of vessel and aircraft but not time or voyage charter income from vessel or aircraft. They are considered income from the operation of vessel or aircraft[68].

The term "attributable to a fixed place of business" is defined so that, if transportation income derived from the bareboat lease of aircraft or vessels is effectively connected with a fixed place of business in the United States, it is attributable to a fixed place of business in the United States[69].

The income from the lease is attributable to a fixed place of business in the United States, even if the lease is subject to final approval of the foreign taxpayer, if the United States office actively participated in the negotiating the lease.

b- Reciprocal Exemption

Prior to the 1986 Tax Reform Act, when a foreign shipping company operated a ship which was registered in a country which granted an equivalent exemption to United States citizens and domestic corporations this enabled the foreign shipping company to be exempted from United States taxation.

The foreign shipping company's country of citizenship or incorporation was not important. For example, if a foreign company is registered in Norway, which does not grant an equivalent exemption to United States citizens and corporations, but flies the flag of Panama which does give relief, the company would be entitled to an exemption. This made it relatively easy to take advantage of the exemption.

The Tax Reform Act of 1986 changed the rules for granting equivalent tax exemption to United States citizens and domestic corporations[70]. After 1986 changings, foreign shipping corporations are subject to United States tax exemption only if 50 per cent of shareholders resided in countries granting equivalent tax exemption to United States citizens and domestic corporations[71].

The new requirements, apply to transport companies who want to use reciprocal exemption rules, are the residence and the shareholder tests, known as the "*shareholder-based residence test*" or "*look-through rule*"[72]. The reason behind this policy is to encourage more countries to enter tax agreements with the United States[73].

After the 1986 changes, the foreign shipping companies who fly with a flag of convenience, cannot apply for reciprocal exemption when their country of residence or incorporation does not grant reciprocal exemption to United States citizens and corporations.

One of the problems is that, it is not clear if this provision will apply to a corporation resident in a jurisdiction which imposes no tax on any business operation or imposes an extremely low rate of tax, such as Barbados. For example, Revenue Canada's attitude is generally towards the extension of the exemption of corporations' resident in countries which impose no income tax[74].

The reciprocal exemption system could apply appropriately between countries where the international traffic is equal or at least similar. Otherwise, only one country gains tax revenues and this is especially likely in the context of agreements between developed and developing countries. When the developed country gains revenue under reciprocal exemption, the developing country loses the opportunity to tax this income. Since developing countries do not have a developed transportation system, reciprocal exemption does not effect the developed countries' level of tax revenues negatively.

One impact of reciprocal exemption is to reduce the price of shipping services, because, after the reciprocal exemption international transportation

companies will not be subject to double tax and for this reason, they will not have to pass on the cost to the customer[75]. In a competitive market place it is the consumer who ultimately benefits from exemption from taxes[76].

Another problem related to reciprocal exemption is the question of how one is to determine the taxable amount of the income of the foreign transportation companies. In most cases, the foreign transportation companies will use an agent in a local office. Where the agent is paid on a commission basis the amount at which he is paid might form starting point for the assesment of the company's income[77].

Otherwise, the international transportation companies may give false or no information about the actual amount of their transportation income which could be subject to tax in that country.

It is quite interesting to note that, until recently some states in the United States did not recognise the exemption of foreign shipping and airline company income under section 883(a) of the Internal Revenue Code. For example, New Jersey began to recognise the exemption under section 883 only after 1994[78].

The reciprocal exemption could be effective only between countries that have similar or same level of international transport business. Otherwise, only one country gains benefits and in most cases they are developed countries. Since developing countries do not have developed transportation businesses, they can not increase their tax revenues, if they use source principle, under the reciprocal exemption.

The new "*shareholder-based residence test*" will make it more difficult for shipping companies to escape taxation on their United States source income as the residence of the shareholders of the company becomes relevant instead of only the residence of the company.

The look-through rules will deny reciprocal corporate exemption unless more than 50 percent of the value of the stock of such corporation is owned by individuals who are qualified residents of another qualified foreign country meeting the corporate exemption requirements of Sections 883(a)(1) or (2)[79].

A look through rule does not apply to a qualified publicly traded corporation and controlled foreign corporations[80]. A qualified publicly traded corporation is a company which is organized in a qualified foreign country, the stock of which is primarily[81] and regularly traded on an established securities market in the foreign country in which such a corporation is organized or in the United States[82].

When examining the look-through rule one observes its fragile situation. This is a 50/50 rule, which means that 50 percent of a corporation's stock value must be held by qualified residents. If 49 per cent is held by qualified residents, the entire amount of the United States source gross transportation income would be subject to tax, but if a single share were to be transferred to a qualified resident, 100 percent of the gross income would be exempted[83].

It is very probable that the qualified residents who hold less than 50 percent of a corporation's stock will always attempt to transfer the necessary shares to reach the 50 per cent threshold to qualify for full exemption. Furthermore, it is important to remember that, if shipping and aircraft income is exempted under any United States tax convention, the corporate exemption look-through rules do not apply[84].

When shipping companies ultimate shareholders reside in the company's incorporated country which grants an equivalent exemption or they are citizens of another foreign country which grants an equivalent exemption to United States citizens and corporations, the reciprocal exemption will apply to a foreign corporation.

The reciprocal exemptions also apply to all rental income from leasing ships and aircraft on a full or bareboat basis[85]. All rental income from leasing ships and aircraft on a full or bareboat basis can qualify for reciprocal exemption under the 1986 Internal Revenue Code. Prior to the Code only incidental rental income from the operation of ships and aircraft could qualify for reciprocal exemption. Also both United States and other country can apply reciprocal exemption on a partial basis if they agree[86].

c- 50% Source Rule

With the Tax Reform Act of 1986, 50 per cent of all transportation income attributable to transportation which *begins or ends* in the United States is treated as United States source income[87]. Also, Section 863(c)(1) still provides that all transportation income attributable to transportation which *begins and ends* in the United States is treated as United States source income.

Prior to 1986, the foreign corporations' income from transportation to or from the United States as allocated between the United States and foreign sources according to how long the ship or aircraft was within United States territorial waters. Since the United States

had a three-mile territorial limit and income from United States sources was limited to income deriving from the United States territorial waters or airspace. All income derived from outside the United States territorial waters or airspace was deemed to be foreign income[88].

This rule was manipulated easily since very small portion of any voyage was spent within United States territorial waters or air space. For this reason, the United States revenue from taxation of foreign transportation companies was very low[89].

The Internal Revenue Code applies without difficulty to allocate income of a non-stop flight between two destinations. For example, a direct flight between Washington and London presents no conflict of allocation of income. 50 per cent of the income would be considered United States source income under Section 863(c)(2).

However, a problem exists if the flight involves more than two destinations. If the flight stops in Toronto, for instance, ticket sales for the passengers who travelled from London to Toronto would not be considered as United States source income. The rules would apply only for the ticket sales for passengers who travelled from London to Washington and Toronto to Washington. For this reason it is necessary to make different allocations of incomes for different routes. The rule applies not only for passengers but also for cargo[90].

Another problematic area is round-trip travel that begins and ends in the United States. Although air transportation presents no problem, a round-the-world cruise which begins and ends in United States presents important complications. According to the Blue Book[91] only 50 percent of the income derived from the first and last legs of the cruise would be considered United States source. For that reason transportation companies would want to keep the first and last legs of cruise as short as possible to minimize United States source income[92].

3- Conclusion

In the United States, although the 1986 Tax Reform Act has changed many parts of Internal Revenue Code as it applies to international transportation companies, still some terms need definition such as "regularly scheduled transportation" and "use" in the definition of transportation income.

Also, under new share based-residence tests or look-through rules in the United States, the foreign transportation companies will find it difficult to satisfy the new tests. In fact, the United States Internal Revenue wanted this new test since companies were too easily entitled to reciprocal exemption.

It is possible to say that the stance of United States disadvantages many countries since the United States has a well-developed transportation system and whenever they sign a reciprocal exemption with other countries which do not have a developed transportation system the agreement benefits the United States.

The signing of a reciprocal agreement would be more reasonable if all the agreements could be signed under the OECD, the United Nations or another model on which most countries were agreed certain principles or alternatives to protect the interest of all countries'.

Although the determination of 50 per cent rule is important, the timing of 50 per cent rule is not clear. The question is how long the shareholders must hold 50 per cent of the shares during a taxable year. The answer could be at least 90 per cent of the total days in a calendar year.

Allocation of income is another problematic area. After the introduction of 50 per cent rule in the United States, for example, a round-the-world cruise which begins and ends in United States causes problems. Transportation companies want to keep the first and last legs of the cruise as short as possible to minimise the United States source income since the Joint Committee on Taxation states that only 50 per cent of the income from the first and last legs of the cruise would be considered United States source income. The same rules which apply to the other types of transportation, should apply to the round-trip travel companies.

FOOTNOTES

[1] Kragen, p.306; Rosenbloom - Langbein, p.361; Lidstone, p.922; Vogel, p.8; for the history of double taxation in the United States see: Seligman, pp.99-125.
[2] Rosenbloom - Langbein, p.365.
[3] 49 Stat. 3145, Treaty Series, No: 885.
[4] 56 Stat. 1399, Treaty Series, No: 983.
[5] 54 Stat. 1759, Treaty Series, No:958 (In spite of revisal by a 1963 protocol (15 U.S.T. 1824, T.I.A.S. No.5656) it is still in effect and is the oldest United States treaty).
[6] Rosenbloom - Langbein, p.374; Kragen, p.306.
[7] This type of treaty applies to all or most types of income (Baker: 1990, p.10).
[8] Treaty Series 988. A new treaty signed in 1967 (19 U.S.T. 5280, T.I.A.S., No.6518) and revised by protocols in 1970 (23 U.S.T. 20, T.I.A.S. No.7270) and in 1978 (19 U.S.T. 5280, T.I.A.S. No.9500)
[9] 56 Stat. 1399, T.S. No:983. It was substantially revised in 1950 (2 U.S.T. 2235, T.I.A.S. No.2347).
[10] Those were with Australia, Austria, Belgium, Denmark, Finland, Germany, Greece, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Pakistan, South Africa, Switzerland and the United Kingdom.
[11] 6 U.S.T. 3696, T.I.A.S. No.3366.
[12] 10 U.S.T. 1358, T.I.A.S. No.4280.
[13] 9 U.S.T. 1459, T.I.A.S. No.4141.

[14] Those were with Belgium, Brazil, Finland, France, Iceland, Israel, Japan, Korea, Luxembourg, Philippines, Poland, Romania, Thailand, Trinidad and Tobago, the United Kingdom and the U.S.S.R..
[15] Daily Tax Reporter, No.97(18.5.1976); The United States Treasury, Treasury Department's Model Income Tax Treaties, United States Treasury Press Release, 18.5.1976, 41 Federal Regulations 20, 427(1976), United States Department of the Treasury, "Model Income Tax Treaty of 17 May 1977", *Bulletin for International Fiscal Documentation*, Vol.31(1977), p.313.
[16] Daily Tax Reporter, No.99(20.5.1977); The United States Treasury Department's Model Income Tax Treaty of May 17, 1977 reprinted in *Tax Treaties(CCH)*, Vol.1(1981), p.153 and U.S. Department of The Treasury, "Model Income Tax Treaty of 17.5.1977", *Bulletin of International Fiscal Documentation*, Vol.31(1977), p.313.
[17] The United States Federal Regulations, Vol.41, No.20.427 (1976); Vol. 42, No: 25.394 and 25.395 (1977).
[18] Daily Tax Reporter, No.115(16.6.1981); The United States Department of the Treasury, "Model Income Tax Treaty of 16.6.1981", *Bulletin of International Fiscal Documentation*, Vol.36(1982), p.15; The New York State Bar Association Tax Section - Committee on United States Activities of Foreign Taxpayers, p.219.
[19] The United States, "Treasury Department Model Income Tax Treaty"; *Tax Treaties(CCH)*, Vol.1(1981), p.211 and *Bulletin for International Fiscal Documentation*, Vol.36(1982), p.15; Becker - Wurm, p.2; Lerner - Lebowitz - Pridjian, pp.32-34.
[20] Vogel, p.10; See for the United States tax treaty policy and procedure: Joint Committee on Taxation, pp.43-55.
[21] Bennett, p.339.
[22] Http://www.ustreas.gov/treasury/tax/t0txmod1.html.
[23] Hereinafter referred as 1996 U.S. Model.
[24] The United States Constitution, Article II, section 2.
[25] The United States Model Income Tax Convention of 20.9.1996.
[26] An "enterprise of a contracting state" is an enterprise carried on by a resident of a contracting state. (U.S. Model Convention, Article 3(1)(c).)
[27] See, Doernberg, pp.78-79.
[28] Patrick, p.653; New York State Bar Association-Tax Section, p.253.
[29] The United States Model, Articles 8(2)and 8(3).
[30] 30.5.1996, ETSC 1 No.9(1996).
[31] 19.9.1993, ETSC 3 No.3(1994).
[32] 6.5.1948, ETSC 3 No.2(1995).
[33] 21.8.1989, ETSC 4 No.2(1991).
[34] 31.8.1994, ETSC 5 No.2(1996).
[35] 29.8.1989, ETSC 6 No.1(1995).
[36] 12.2.1979, ETSC 6 No. 1(1979).
[37] 17.4.1984, ETSC 7 No.3(1990).
[38] 3.4.1996, ETSC 8 No.7(1996).
[39] 6.8.1994, ETSC 10 No.3(1996).
[40] 17.6.1992, ETSC 10 No.11(1996).
[41] 22.2.1990, ETSC 10 No.6(1991).
[42] 1.9.1994, ETSC 11 No.12(1995).
[43] 2.10.1996.
[44] Article 3(1).
[45] 29.4.1948, T.D. 5778, 1950-1 C.B. 92 and 1967-2 C.B.472.
[46] The Revenue Ruling 76-568 (IRB 1976-52, 76).
[47] The Revenue Ruling 90-37, 1990.
[48] TIAS 3133, 1955-1 C.B. 635.
[49] Edwardes-Ker, p.8 of Article 8.
[50] The Revenue Ruling 72-624 (1972-2 C.B. 659).
[51] 1954 IRC, Sections 872(b)(2) and 883(a)(2).
[52] Edwardes-Ker, p.8 of Article 8; See, the Revenue Ruling 72-624, 1972.
[53] (1995), 104 TC 535 in Davison, p.102.
[54] Ibid., p.108.
[55] Idem.
[56] 34 T.C. 894 (1960), 299 F.2d 623 (1962) in Tremblay, p.309.
[57] "Foreign Corporations" are corporations that are created or organised outside the United States and under the laws of a country other than the United States; I.R.C. Sections 7701(a)(4), 7701(a)(5), 1982 (Hereinafter referred to as IRC).
[58] The Staff of the Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1986 (Blue Book - Public Law, 99-514, 22.10.1986, H.R.3838, 99th Congress), Federal Taxes, Prentice-Hall, 5.11.1987, Bulletin 20 Extra, pp.924-932 (Hereinafter referred as Blue Book); The Tax Reform Bill of 1985 (known as "the House Bill") was first presented by the "House Ways and Means Committee" in December-1985, and was later supplemented by H.R. 3838 (the Tax Reform Bill of 1986) by the Senate Finance Committee in June-1986 (the "Senate Bill"). See for details, Klein - Zerbo, pp.297-326.
[59] The Complete Guide to the Tax Reform Act of 1986, Federal Tax Guide, Prentice-Hall, 18.10.1986, Bulletin No.33, pp.1207-1208; The Subcommittee (on tax treaties) of the Committee on United States Activities of Foreigners and Tax Treaties, Section of Taxation, American Bar Association (Hereinafter referred to as the 'Subcommittee of American Bar Association': "Issues Paper on Technical Corrections to the Tax Reform Act of 1986 Relating to Tax Treaties", *Tax Management International Journal*, No.8, August-1988, pp.348-349 (Members of the Committee are M.J.A. Karlin, D.L. Raish, L. De Vos, J.C. Holberton, R.B. Kelley, E.W. Kvam, T.A. Maier, S.A. Musher, R.B. Williams); Zerbo, p.235; Doernberg, pp.47-48; Fuller, p.17; Levine- Berger, pp.1215-1216; Garrison, p.152; For details of pre-1986 system see, Field - Gordon, op. cit., pp.68-97.
[60] IRC, Section 887; The offer to change the rate from 4 % to 8 % is rejected by the Ways and Means Comittee on 27.7.1994 - Kirchheimer, p.419.
[61] This is included in Section 887(a) and was applicable from 1.1.1987 (IRC, Section 1212(b)).
[62] The American Law Institute has made some recommendations about effectively connected income see, The American Law Institute, pp. 78-85.
[63] "Substantially all" in this context means 90% or more (The Revenue Ruling 91-12, 1991-1 C.B. 474, Section 4.06).
[64] IRC, Sections 887(b)(4) and 887(b)(4)(B); also see 864(c).
[65] The Revenue Ruling 91-12, 1991-1 C.B. 474, Section 4.03.
[66] The Revenue Ruling 91-12, 1991-1 C.B. 474, Section 4.07.
[67] The Revenue Ruling 91-12, 1991-1 C.B. 474, Section 4.04.
[68] The Revenue Ruling 91-12, 1991-1 C.B. 474, Section 4.08.
[69] The Revenue Ruling 91-12, 1991-1 C.B. 474, Section 4.09.
[70] The Joint Committee on Taxation, pp.926-927.
[71] IRC, Sections 883(a)(1) and 883(c)(1); The Revenue Ruling 87-15, 1987-6 IRB 15.
[72] IRC, Section, 883(c). Although the original rate of the look-through rule was 75% in the House version, it was reduced to 50% by the Senate.
[73] The Joint Committee on Taxation, pp.926-927.
[74] The Revenue Canada - 1991 Technical Interpretation, p.4.
[75] Field-Gordon, p.71.
[76] Idem.
[77] Ibid., p.83.
[78] Costenbader, p.232.
[79] IRC, Section 883(c)(1).
[80] IRC, Sections 951 and 954.
[81] "Primarily" means that more shares trade in the country of organizations than in any other country. The Senate Report, at pp.343-344.
[82] IRC, Section 883(c)(3).
[83] Outterson - Cheung, p.593.
[84] The Revenue Ruling, 89-42, at 234.
[85] The House of Representives Report, No. 841, 99th Congress, 2nd Session II-598; Levine-Berger, op. cit., p.1217; Tsiros, op. cit., p.387.
[86] Levine-Berger, p.1217.
[87] IRC, Section 863(c)(2).
[88] Field - Gordon, p.70.
[89] The Revenue Ruling 75-483, 1975-2 CB 286; Blue Book, pp.926-927; Zerbo, p.235; Garrison, p.152; Subcommittee of American Bar

Association, p.348; Fuller, p.79; Outterson-Cheung, p.589, footnote 18.1.

[90] The Senate Report, p.341.

[91] Blue Book, p.929.

[92] Garrison, p.154; Zerbo, pp.235-236; Outterson - Cheung, p.590, footnote-23.

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