



# Income Tax Treaties

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## Agenda

- Tax Treaty Overview/How Treaties Work
- IRS Sources
- Taxes Covered
- Persons Covered
- Articles Conferring Benefits
- Benefit Limitations
- Treaty Claim Forms
- Software Demo

## Definition of Terms

- Convention = an income tax treaty
- Bilateral agreement = an agreement between two parties
- Protocol = an amendment to a treaty
- Contracting states = the treaty countries
- Articles = topical sections describing benefits and limitations
- Treaty tax exemption = treaty benefit

## What Tax Treaties Do

Purpose is to avoid double taxation

- Residence-based and source-country taxation
- But do not avoid citizenship-based taxation

Exemptions foster international exchange

Assist with enforcement of tax compliance

- Exchange of information
- Admin help with collecting treaty partner's taxes

## New Treaty, Special Provisions

Replacement treaty may include

- A one-year election for prior treaty benefit
- Carryover benefit for student/trainee or teacher/researcher benefits eliminated by new treaty

## Current Status of Tax Treaties

Tax treaties in force with over 60 countries

Pending:

- Replacement treaty for Hungary
- New treaty with Chile (no prior treaty)
- Japan (protocol)
- Spain (protocol)
- Poland (new treaty)
- Luxembourg (protocol)
- Switzerland (protocol)

## IRS Tax Treaty Information

Full treaty texts available on the IRS website, [www.irs.gov](http://www.irs.gov) (search on "treaties")

- Treasury Explanations
- Overview tables – Search IRS website for “Tax Treaty Tables”

## IRS Tax Treaty Tables

Table 1 - passive income

- Interest
- Dividends
- Pensions/Annuities
- Social Security
- Royalties

## IRS Tax Treaty Tables

Table 2 - income related to US activities

- Dependent Personal Services (Employment)
- Independent Personal Services (Self-employment)
- Artists and Athletes (Entertainers and Sportsmen)
- Students and Trainees
- Teachers and Researchers

## IRS Tax Treaty Tables – Table 2

Country (1)	Code <sup>1</sup> (2)	Purpose <sup>22</sup> (3)	Maximum Presence in U.S. (4)	Required Employer or Payer (5)	Maximum Amount of Compensation (6)	Treaty Article Citation (7)
Netherlands	16	Scholarship or fellowship grant <sup>15,33</sup>	3 years	Any U.S. or foreign resident <sup>5</sup>	No limit	22(2)
	17	Independent personal services <sup>7</sup>	No limit	Any contractor	No limit	15
	18	Dependent personal services <sup>17, 47, 58</sup>	183 days	Any foreign resident	No limit	16
	42	Public entertainment	No limit	Any U.S. or foreign resident	\$10,000 p.a. <sup>25</sup>	18
	19	Teaching <sup>4, 34</sup>	2 years	U.S. educational institution	No limit	21(1)
	20	Studying and training: <sup>33</sup>				
		Remittances or allowances	Reasonable period	Any foreign resident	No limit	22(1)
		Compensation while gaining experience	Reasonable period	Any U.S. or foreign resident	\$2,000 p.a.	22(1)
		Compensation while recipient of scholarship or fellowship grant	Reasonable period	Any U.S. or foreign resident	\$2,000 p.a. <sup>36</sup>	22(2)

## Taxes Covered by Tax Treaties

Federal income taxes

Not Social Security and Medicare taxes

- Except Former USSR/CIS treaty applies to employee share of FICA (not employer's share – an excise tax)

Not state income taxes

- But might be covered indirectly
- About 14 states not covered

## Persons Covered by Tax Treaties

Persons = individuals and entities

Persons resident in the treaty country

- Resident for tax purposes
- Treaty benefits are NOT based on citizenship

## Timing for Eligibility Purposes

Timing of treaty country residency varies by treaty article

- Most articles – throughout the benefit period
- But Student/Trainee, Teacher/Researcher Articles – typically at beginning of the visit
  - Caution with exceptions!

## Impact of US Residency Status

Residency status is based on the treaty country's internal law

- US: Foreign nationals are either nonresident aliens (NRAs) or resident aliens (RAs)

RAs lose most treaty benefits due to the saving clause (next slide)

## The Saving Clause

Included in all treaties; allows US to tax citizens and residents as if the treaty had not come into effect

Exceptions for specified treaty articles

- But not for Greece and Pakistan

Exceptions do not apply to US citizens/LPRs

- But China, former USSR treaties have exceptions for LPRs

## Articles Conferring Benefits

Two types of articles:

Purpose-of-the-visit articles

- Student/Trainee Articles
- Teacher/Researcher Articles
  - Typically covered by Saving Clause exception

Character-of-the-payment – all other articles

- Focus on nature of payment
  - Caution: Benefits lost by gaining US residency status or losing treaty country residency status!



## Student/Trainee Articles

May Confer Benefits for some or all of:

- Gifts from abroad for education or training
- Compensation during study or training
- Grant, allowance, or award - direct non-service scholarship or fellowship
- Researcher benefits for direct grant recipients

## Teacher/Researcher Articles

May confer benefits for some or all of:

- Compensation for teaching or engaging in research (research must be for public benefit)
  - But no research benefit for Greece and Pakistan
- At a 'school, college, university or other accredited educational institution'
  - Some treaties include research institutes

## Benefit Limitations

Described in Table 2 overview

- Required employer or payer (column 5)
  - Caution: Benefit may require a foreign resident or treaty-country resident employer/payer
- Maximum presence in US (column 4)
  - Year may be either tax year, elapsed year, or 12-month period beginning or ending in tax year
  - Caution: Benefit generally lost if time period exceeded
- Maximum amount (column 6)
  - Caution: Benefit generally lost if amount exceeded
    - But there are some exceptions for purpose-of-the-visit articles!

## Purpose-of-the-Visit Limitations

Prospective loss – visiting the US for “a period *not expected to exceed 2 years*”

- Based on information known to either employer or employee or both
- Much recent case law due to IRS audits

Retroactive loss – “...who visits the other Contracting State *for a period not exceeding two years...*”

- Benefit lost retroactively if time period physically exceeded for any reason
- 6 treaties - Germany (Student/Trainee only), India, Luxembourg, Netherlands, Thailand, UK

## Purpose-of-the-Visit Limitations

### Once-in-a-lifetime use

- “An individual shall be entitled to the benefits of this paragraph only once.”
- 6 treaties – Czech Republic, France, Indonesia, Jamaica, Portugal, Slovak Republic
- China Teacher/Researcher benefit also interpreted as one-time use due to “in the aggregate” language

## Character-of-the-Payment Limitations

### Unique provision for residents of Canada and Greece paid by a US employer

- Under Dependent Personal Services Article (report under Income Code 18)
- Compensation to a maximum of \$10,000
- Benefit lost if
  - Amount exceeded by 1¢
  - Recipient becomes an RA

## Character-of-the-Payment Limitations

### Artists and Athletes

- No benefit if gross receipts amount exceeded
- Gross receipts includes travel reimbursements excluded under an accountable plan
- IRS: Do not provide withholding tax exemption if article includes a gross receipts maximum

## Character-of-the-Payment Limitations

No treaty benefit if the income is attributable to a US fixed base

- Almost all FDAP-type income articles
- Most Independent Personal Services Articles

### A fixed base

- Is a fixed place of business through which the business is carried on
- Same as permanent establishment as defined by the treaty

## Withholding Tax Exemption Claim

Form 8233 for personal services by an NRA

- Can include scholarship/fellowship grants if also have treaty-exempt compensation

Form W-8BEN for all other treaty claims by NRAs (W-8BEN-E for entities)

Form W-9 for claims by RAs allowed under a saving clause exception

# Software Demo