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Tax Strategies

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Applying the New US-UK Income Tax Treaty to Pensions
Successes and Shortcomings

BY KIMBERLY BLANCHARD
(WEIL, GOTSHAL & MANGES)

This article examines the application of the new US-UK income tax treaty to pensions, using examples illustrating a series of increasing more complex cross-border employment arrangements.

Introduction

Since the text of the new US-UK income tax treaty (the "Treaty") was first released for public view in late 2001, much has been written and remarked about Article 18, relating to pensions. It is not the purpose of this article to review the pension provisions of the Treaty in broad outline; that task has been ably performed by others, particularly Hall (*Employee Benefits and Compensation Under New US-UK Tax Treaty*, 30 Tax Mgmt. Comp. Plan. J. 3 (January 4,

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Advising Clients on Internet Server Co-Location Agreements
Tax Issues for Businesses with Servers in the US

BY HANNAH TERHUNE
(GREENTRADERTAX.COM)

In this article, the author makes sense out of the confusion over the US taxation of Internet-based global e-commerce activities.

It is possible to operate a business globally over the Internet using only a computer server. An Internet server co-location agreement provides you with leased space in a physically secure facility where you can store and operate your computer server on a 24-hour, 365-day basis. If you are involved in a business in which co-location arrangements are extremely relevant to the success of that business, or are considering entering into co-location arrangements for your business, this article will be of great interest to you.

It is probably best to be upfront about the conclusion reached in this article. Despite murmurings to the contrary, it is reasonable to conclude that Internet server co-location arrangements result in a taxable presence in

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Tax Treaties
This issue of *Practical Strategies* opens with an article on how to apply the new US-UK income tax treaty to pension plans. The article uses a number of examples to show how the pension provisions and savings clause in the new US-UK treaty interact in cross-border employment situations.
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E-Commerce
Many lawmakers and their advisors on both sides of the Atlantic believe that they might need to change the definition of a permanent establishment to reach new, purely Internet-based business activities. In this regard, we bring you an article on the current US tax treatment of Internet server co-location arrangements.
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the state (let alone a permanent establishment in the country) in which the server is physically located. Globally-focused clients should be advised accordingly.

Despite murmurings to the contrary, it is reasonable to conclude that Internet server co-location arrangements result in a taxable presence in the state (let alone a permanent establishment in the country) in which the server is physically located. Globally-focused clients should be advised accordingly.

To PE or Not To PE?

Some lawmakers and their legal advisors on both sides of the Atlantic believe that the most critical issue affecting electronic commerce is whether there is a need to modify the existing definition of a permanent establishment (a "PE") to conform to technological advances. Stated otherwise, the debated question is whether a computer server creates a taxable PE.

With the issue framed in this way, it can be understood why there has been precious little more than academic debate, let alone published guidance on the matter. If the US is waiting for the Organization for Economic Cooperation and Development (the "OECD") to act on the computer server/PE debate, it can exhale. Changing the PE definition would affect over 1500 tax treaties.

While unresolved (and nearly existential) international debate continues, it seems that a number of US states, without waiting for either the US federal government or the OECD to act, have staked out a reasonable legal (*i.e.*, tax return) position. The American states are asserting tax jurisdiction over companies that locate computer servers within their borders. Given that most tax authori-

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PRACTICAL US/INTERNATIONAL TAX STRATEGIES

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PUBLICATION STAFF

PUBLISHER: Gary A. Brown, Esq. EDITOR: David R. Cooper, Esq.
STAFF: Justine McCallum, Dana Pierce. BUSINESS MANAGER: Ken Parker.

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Planning Advisory

"Abusive" Foreign Tax Credit Structures

More on the Latest IRS Guidance

BY SAM KAYWOOD, KEVIN ROWE,
AND EDWARD TANENBAUM (ALSTON & BIRD)

Following our coverage in the last issue of *Practical Strategies*, this article provides greater insight into the US tax authorities' latest positions on what they consider to be "abusive" foreign tax credit structures.

Overview

In Notice 2004-19, the US Treasury Department and the Internal Revenue Service have abandoned proposals, first announced in Notice 98-5, 1998-1 C.B. 334, to require foreign tax credit planning structures to satisfy a broadly worded "economic profit" test. Instead, the US tax authorities have presented various specific steps they intend to take to combat abusive foreign tax credit planning. In the companion Notice 2004-20, a "foreign tax credit intermediary transaction" has been rejected under existing rules.

Notice 98-5

Notice 98-5 identified two general patterns of abusive transactions involving foreign tax credits. Arguably, both transactional patterns have been built on flaws in the foreign tax credit system, which essentially holds that foreign income taxes are creditable against US income tax, subject to the foreign tax credit limitation.

The foreign tax credit limitation rules provide that the maximum foreign tax credit cannot exceed the percentage of pre-credit US income tax that is attributable to foreign-source taxable income. In applying the limitation, income is first allocated among nine baskets of income (including passive income, financial services income, and residual income). The limitation formula is then applied separately to each basket.

The first transactional pattern in Notice 98-5 involves the acquisition of an income-generating asset subject to foreign gross basis tax (*e.g.*, a withholding tax) for a very short holding period in which income is realized and with respect to which the creditable foreign withholding tax is imposed. The purpose of this transaction is to obtain a foreign tax credit and it is assumed that the pricing is arranged accordingly.

The US tax authorities have abandoned proposals to require foreign tax credit planning structures to satisfy a broadly worded "economic profit" test. Instead, the authorities have presented various specific steps they intend to take to combat abusive foreign tax credit planning.

This type of transaction is built on the basic foreign tax credit rule that the "technical taxpayer" (*i.e.*, the person that actually pays the foreign income tax) is entitled to the credit whether or not that person bears the economic burden of the foreign tax or derives the economic benefit of the underlying income.

The second transactional pattern addressed in Notice 98-5 involves structures designed to exploit inconsistencies between US tax law and foreign tax law to generate duplicate benefits. Among other things, these transactions are built on the principle that the foreign tax credit limitation formula does not "trace" the specific items of income that were subject to tax by the foreign juris-

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diction; rather, foreign income and related foreign income taxes are assigned to the appropriate basket. Consequently, small amounts of taxable income as determined under US rules may carry substantial amounts of foreign tax credits that may offset US income tax on income assigned to a particular basket.

Thus, if a taxpayer has an excess foreign tax credit limitation (*i.e.*, the US income tax on its foreign-source income is higher than the available foreign tax credits), the taxpayer might seek to acquire additional foreign tax credits.

Notice 2004-19 and Notice 2004-20 suggest renewed IRS attention to foreign tax credit planning structures. Although Notice 98-5 was revoked, the end result may be a broader attack on foreign tax credit schemes. This is a good time to review your foreign tax credit structures.

Notice 98-5 took the position that the principal indicia of abuse was the absence of a reasonably expected economic profit from participating in a transaction (without considering tax savings), coupled with the reasonable expectation of significant tax reduction from using the foreign tax credits. Notice 98-5 said that regulations would contain a general rule disallowing foreign tax credits resulting from a transaction in which the "reasonably expected economic profit" is insubstantial compared to the foreign tax credits expected from the transaction.

Withdrawal of Notice 98-5

Notice 98-5 was heavily criticized on the ground that the economic substance test would not identify abusive situations. There were questions about whether an economic substance rule is consistent with the "technical taxpayer" rule.

Moreover, the enactment of §901(k) of the Internal Revenue Code, requiring a minimum holding period for stock before a foreign tax credit can be taken on withholding tax imposed on dividends paid on the stock, raises serious questions as to whether the first transactional pattern is inconsistent with the law (a view supported by the *Compaq* case, which for years predating §901(k) of the Code rejected a minimum holding period for claiming a foreign tax credit on tax imposed on dividends).

Notice 2004-19 announced that the economic substance regulations of Notice 98-5 would not be issued. Instead, abusive foreign tax credit transactions will be attacked using existing law, including the substance over form and step transaction doctrines, debt-equity principles, §269 of the Code, and the general partnership anti-abuse rules. Notice 2004-19 also states that the US Treasury Department favors certain legislative changes, including the expansion of §901(k).

Notice 2004-20

Notice 2004-20 is an example of the new approach -- it analyzes a discrete transaction under some of the principles outlined in Notice 2004-19.

Notice 2004-20 involves a foreign corporation ("T") that desires to sell all, or a substantial portion of, its business assets (which are not used in a US trade or business), a buyer ("B") with no US connection that wishes to purchase T's assets, and a US corporation ("M") that needs foreign tax credits (*i.e.*, it has an excess foreign tax limitation -- presumably in its general limitation basket).

Pursuant to a prearranged plan, T's shareholders sell their T stock to M and M makes an election under §338 of the Code to treat the sale as a sale by T of all of its assets to a hypothetical corporation ("New T").

For US income tax purposes, New T takes a fair market value basis in the T assets (even though no taxable gain is generated in the deemed asset sale) and none of T's tax history, such as earnings and profits, carries over to New T. M liquidates T and M takes a fair market value basis in T's assets for US tax purposes (most likely the liquidation would be the result of electing "disregarded entity" status for T under the US check-the-box regime, although Notice 2004-20 suggests an actual liquidation under local law might be feasible). Next, B acquires T's assets from T.

Under local tax law, T hasn't changed (as a result of the §338 election or the check-the-box election) and it will incur local income tax on gain recognized on the sale of its assets. For US income tax purposes, however, M is treated as the seller and it is deemed to pay the foreign income tax paid by T on the asset sale.

Even though M realizes no gain on the asset sale for US income tax purposes, it can claim a foreign tax credit with respect to local tax because the foreign tax credit limitation regime does not "trace" the specific items of income on which foreign tax

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was imposed. Rather, income and foreign tax is assigned to baskets and a credit is allowed to the extent the foreign tax does not exceed the US income tax on the foreign source income assigned to the basket.

Notice 2004-20 holds that M is not entitled to a foreign tax credit for foreign income tax incurred on the T asset sale because there is no risk that M would suffer double tax on income from that sale (and no need to invoke the foreign tax credit regime if there is no income subject to double taxation).

The IRS argued that, under the step transaction and substance over form doctrines, and the *Court Holding* and *Aiken Industries* cases, M's role in the transaction should be disregarded. Alternatively, M's ownership of T could be disregarded under agency principles, or the IRS might invoke §269 of the Code to deny tax benefits resulting from acquisitions made with a principal purpose of evading or avoiding income tax.

Effective February 17, 2004, transactions that are the same as, or substantially similar to, the transaction described above are "listed transactions" subject to the US tax shelter reporting and disclosure requirements.

Planning Considerations

Notice 2004-19 and Notice 2004-20 suggest renewed IRS attention to foreign tax credit planning structures. Although Notice 98-5 was revoked, the end result may be a broader attack on foreign tax credit schemes. This is a good time to review your foreign tax credit structures. ❑

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Reporting Requirements

New Guidance on Using Schedule M-3

The US Treasury Department and Internal Revenue Service have released draft instructions on using Schedule M-3, *Net Income (Loss) Reconciliation for Corporations with Total Assets of $10 Million or More.*

Schedule M-3, which was released in draft form on January 28, 2004, will be used by large and mid-size business taxpayers (*i.e.*, those with total assets of $10 million or more) that file IRS Form 1120, *US Corporation Income Tax Return*. The new Schedule M-3 expands upon the current Schedule M-1, which has not been updated in several decades.

For details on the content of the new Schedule M-3 and the US tax authorities' rationale for adopting it, including how US consolidated groups with foreign subsidiaries must extract information for purposes of completing Schedule M-3, *see* the February 15, 2004 issue of *Practical US/International Tax Strategies* (Vol. 8, No. 3).

"The release of the draft Schedule M-3 instructions is the next step towards making differences between financial accounting net income and taxable income more transparent. We look forward to taxpayer comments on Schedule M-3 and how Treasury and IRS can make sure completing the new M-3 is as easy as possible for taxpayers," said Greg Jenner, the Acting Treasury Assistant Secretary for Tax Policy.

The US Treasury Department and the IRS expect to have the proposed Schedule M-3 finalized and ready for use by US corporate taxpayers with their federal income tax returns for tax years ending on or after December 31, 2004.

The new draft Schedule M-3 and the instructions to it are available on the IRS website at *www.irs.gov*.

Source: US Treasury Department Release No. JS-1232. ❑

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2002)). Instead, this article focuses on the complex, and sometimes unclear or surprising, interaction of the Treaty's pension provisions and the savings clause.

Absent a tax treaty, the US (and, generally, the UK) would tax contributions made to a foreign pension plan as current compensation to the plan participant -- like any other contribution to a nonqualified plan. A major goal of Article 18 is to override this result.

Absent a tax treaty, the US (and, generally, the UK) would tax contributions made to a foreign pension plan as current compensation to the plan participant -- that is, like any other contribution to a nonqualified plan. A major goal of Article 18 is to override this result by requiring each country to recognize qualifying plans formed in the other country as if the foreign plan were the equivalent of a domestic qualified plan.

In very general terms, Article 18 attempts to reduce or eliminate the double taxation of individuals who may be subject to tax on a worldwide basis, at different points in their lives, in one state, but who are covered by a pension plan established under the laws of the other state.

Much of Article 18 is new to the US-UK relationship, although most of the concepts have been seen in a few earlier US tax treaties. (*See*, *e.g.*, US Model Income Tax Convention of September 20, 1996, Art. 18(6); US/South Africa Double Income Tax Convention, February 17, 1997, Art. 18(6); Canada, Art. 18(7); France, Art. 18(2)(c); The Netherlands, Art. 19(3). *See also* the Organization for Economic Cooperation and Development ("OECD") model treaty at Art. 18, paragraph 11.)

Snapshot

US Senate Signs Off on New US-Japan Treaty

On March 9th, the US Senate approved the new income tax treaty between the US and Japan.

The new income tax treaty is expected to help reduce bilateral tax barriers to cross-border trade and investment between the US and Japan. Among other things, the new treaty includes reciprocal reductions in source-country withholding taxes on income from cross-border investments.

For example, the treaty provides for the complete elimination of withholding taxes on all royalty income. Given the volume and importance of the cross-border use of intangibles between the US and Japan, this is a key provision in the new treaty.

The new treaty also provides for the complete elimination of withholding taxes on certain interest income, including interest income earned by financial institutions, and on dividend income paid to parent companies with a controlling interest in the dividend-paying company.

The new US-Japan income tax treaty will replace the existing income tax treaty in place between the US and Japan, which dates back to 1971.

The new treaty will enter into force when the required exchange of instruments of ratification between the two countries has been completed. The approval of the treaty by the US Senate followed a hearing on the treaty held by the Senate Committee on Foreign Relations on February 25th, and favorable action on the treaty by that committee on March 4th. The treaty currently is under consideration in the Japanese Diet.

Source: US Treasury Department Release No. JS-1227. ❑

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The new rules set out in Article 18 represent a significant improvement over the prior US-UK treaty. In the most common types of cases -- the ones undoubtedly on the Treaty drafters' minds -- the rules should work quite well. Unfortunately, the good intentions behind Article 18 are somewhat undermined by two shortcomings in the article's conceptual approach.

First, the relief provided by Article 18 is generally limited to the relief that would be accorded to a participant under the pension tax provisions of the state in which the individual works. While this rule is easy to justify on policy grounds, it may often be difficult to apply in practice.

For example, recent UK legislation generally imposes a lifetime cap on the amount that can be accumulated tax free in an individual's pension plans. How this rule would operate in a cross-border context is completely unclear.

Second, and probably more seriously, the approach that the drafters took in Article 18 was to provide specific relief for the class of cases the drafters happened to think about, rather than to provide principled rules of general application. As a result, some fact patterns will fall through the cracks, and like cases may sometimes be treated differently.

It is by no means clear that this is what was intended. In future treaties, Article 18 should be redrafted along more principled lines. Otherwise, and for the time being, the competent authorities should devise procedures for resolving cases of unintended double taxation.

General Rules

Three general rules are contained in Article 18, to which one may add three general rules applicable to cross-border pensions found in Article 17. In summary form, the rules are:

1) **"Qualifying Contributions Rule."** Contributions to a pension plan established under the laws of one state, whether made by an individual employee, or his or her employer, are excluded or deducted from the covered individual's income while working in the other state, provided that the coverage began at home prior to the time of the transfer to the work country. Article 18(2).
2) **"Employer Deduction Rule."** Contributions to a pension plan established under the laws of one country are deductible by an employer in the other country. Article 18(2)(b).
3) **"Deferral of Earnings Rule."** Earnings building up inside a pension plan are not taxable until distributed. Article 18(1).
4) **"General Distribution Rule."** Distributions from a pension plan are generally taxable only by the state of residence. Article 17(1)(a).
5) **"Lump-Sum Distribution Rule."** Lump-sum distributions from a pension plan are generally taxable by the source state. Article 17(2).
6) **"Basis Recovery Rule."** The state of residence may not tax a general distribution if the distribution would not be taxable in the source state. Article 17(1)(b).

In addition to these general rules, and the conditions imposed on them, Article 18(5) contains a special, very limited rule that turns off the US savings clause as applied to US citizens who work in the UK. This rule, which does not require coverage to have started prior to the time treaty benefits are claimed, is discussed further below.

Article 18 generally attempts to reduce or eliminate the double taxation of individuals who may be subject to tax on a worldwide basis, at different points in their lives, in one state, but who are covered by a pension plan established under the laws of the other state.

To understand these rules and apply them to real life cases, it is essential not only to study the detailed terminology of Articles 17 and 18, but to keep the Treaty pages open to three collateral provisions that will often determine whether the benefits of Article 18, in particular, are available in a given case. These collateral provisions include:

A) Article 14(2), which limits the right of a state in which a nonresident works to tax him or her on compensation earned for services performed in that state;
B) Article 1(4) and 1(5), being the savings clause and the exceptions to it; and
C) Article 4(2), which limits the ability of a US citizen or green card holder to claim US resi-

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dent status (and incidentally, by interaction with Article 1(4), appears to limit the US ability to apply the savings clause to a green card holder) where the individual has no substantial ties to the US.

In addition, Article 24 (relief from double taxation) and Article 26 (mutual agreement procedure) may be implicated in harder cases.

The relief provided by Article 18 is generally limited to the relief that would be accorded to a participant under the pension tax provisions of the state in which the individual works. While this rule is easy to justify on policy grounds, it may often be difficult to apply in practice.

Probably the best way to gain familiarity with the Treaty regime affecting pensions is to work through a series of examples in which the worker's connection to the source state increases with each example. The first five examples below assume that the worker is an individual who is a participant in a UK pension plan and who is working in the US. The last example concerns a US citizen working in the UK. In each of the examples, the term "work country" is used to refer to the country in which the individual works. The term "plan country" refers to the other country.

Most of the examples here focus on the operation of the qualifying contributions rule in Article 18(2) because it is the most novel and interesting, as well as the most important, of the Treaty's new rules governing pensions. In addition, the employer deduction rule raises some interesting issues on its own.

Example 1
UK Plan Participant Protected Under Article 14

In a significant class of cases, resort to the benefits of Article 18 will not be necessary. Article 18 prevents the work country from taxing contributions made to a pension plan established in the plan country as if such contributions were nonqualified compensation for services. More broadly, Article 14(2) independently prevents the work country from taxing any compensation income of a worker in cases where it applies.

For Article 14(2) to apply, the worker cannot be present in the work state for more than 183 days

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in the year. Moreover, his or her compensation must be borne by a nonresident employer and not by a work state permanent establishment of the nonresident employer. (As the presence of the employee, in some cases, will be deemed to create a permanent establishment, care must be taken in relying on the Article 14 exception.)

In these cases, there is no need to consider Article 18. Presumably, the drafters of the Treaty intended Article 18 for the more difficult case in which the individual is not protected by Article 14.

Note that the protection of Article 14(2) does not extend to a worker who, although present in the work state fewer than 184 days and a UK resident, is also a US resident or US citizen, as to whom the savings clause applies. These cases are addressed below.

The employer deduction rule of Article 18(2) also should not come into play in our first example. For the reasons described below in the next example, the employer deduction rule should come into play only when the individual is employed by a work country subsidiary or permanent establishment of the plan country sponsor. Because Article 14 is available only when the employee's compensation is borne by the plan country entity, no work country deduction should be needed or available.

It would be helpful if the language in Article 18(2) were clearer on this point.

Example 2
UK Plan Participant Not a US Resident or Citizen

Suppose that the protection of Article 14 is not available because the employee's compensation for work performed in the US is borne by a US permanent establishment of his or her UK employer -- not an unusual case. Absent the Treaty, the US could tax the UK plan participant on his or her US-source compensation income, even if he or she is not a US resident. However, in this case, Article 18(2) applies straightforwardly to exclude from his or her US taxable income employer contributions to the plan country pension plan.

One issue in this example, and in the other examples below, is how the employer deduction rule works. Presumably, the US permanent establishment is entitled to deduct contributions made on this worker's account, at least if it "bears" that expense.

However, the language in Article 18(2) is not clear. The employer deduction rule is phrased as follows: "such contributions shall be allowed as a deduction in computing the business profits of [similar language in the employee's] employer in that other [work] State."

The technical explanation of similar language in the 1996 US model treaty uses language that is slightly clearer: "contributions to the plan will be deductible for purposes of computing the employer's taxable income in the State where the individual renders services."

At least one author, in struggling with this language, implicitly assumed that the employer would always be a resident of the work country. (*See* Hall's article referenced above.)

Normally, one would expect that an individual working in the US and covered by a UK pension plan would be employed by a US subsidiary of the UK plan sponsor, or by a US permanent establishment (branch) of the UK plan sponsor. The language of the employer deduction rule seems vague enough to cover both cases.

If the employer is a US subsidiary of a UK parent, the rule merely operates to allow the US employer a deduction for a contribution to a foreign pension plan. If the employer is a US permanent establishment of a UK company, the rule operates both to allow the deduction and to allocate it to the permanent establishment under the principles of Article 7 of the Treaty.

For Article 14(2) to apply, the worker cannot be present in the work state for more than 183 days in the year. Moreover, his or her compensation must be borne by a nonresident employer and not by a work state permanent establishment of the nonresident employer.

However, it is possible that the employer could be the UK entity in its own right. A UK employer cannot use a US deduction; presumably the employer would be entitled to claim a UK deduction.

Thus, the question arises whether the rule could generate double deductions for the same contribution in the UK and in the US. If the employer is a US subsidiary or permanent establish-

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ment of a UK parent, and if the UK parent actually funds the contribution, nothing in Article 18 appears to prevent both the UK parent and the US employer from claiming the deduction.

Perhaps the solution to this problem is to require the employer to bear the economic cost of the contribution to claim the deduction. If so, it should be made clear that the contribution remains excludable from the employee's income, whether or not the cost is borne by, and is therefore deductible by, the employer.

Normally, one would expect that an individual working in the US and covered by a UK pension plan would be employed by a US subsidiary of the UK plan sponsor, or by a US permanent establishment (branch) of the UK plan sponsor. The language of the employer deduction rule seems vague enough to cover both cases.

The deferral of earnings rule, unlike the qualifying contributions and employer deduction rules, is available only to an individual who is a resident of a state other than the plan state. Presumably, the Treaty's drafters assumed that a UK individual could not be taxed in the US on income earned in a UK plan unless he or she was a US resident, so that there was no need to address the case in which the plan participant was not a US resident.

Example 3 UK Plan Participant Also a US Resident Under Substantial Presence Test

One reason, but not the only reason, that Article 14(2) may not be available to an individual is that the individual spends more than 183 days in the work country in a given year. Under the substantial presence test of US law, this alone would be enough (absent some extraordinary exceptions) to make the alien individual a US resident for income tax purposes.

(Of course, a person can be treated as a resident under the substantial presence test even if he or she is physically present in the US for fewer than 183 days in a given year, based on the three-year day counting rule in §7701(b)(3)(A) of the Internal Revenue Code.)

The qualifying contributions rule does not turn on residence. It therefore applies regardless of the residence of the individual employee in question -- at least facially. For this reason, the work country, in this example the US, would continue to be required to grant the exclusion for contributions to the UK plan, even when the worker is a US resident. This result seems to have been clearly intended by the Treaty's drafters.

Even if the US would, under its domestic rules, tax a US resident on contributions made on his or her account to a foreign plan, this is not a case where the US could rely on the savings clause to do so. Article 1(5)(b) provides that the savings clause does not affect the benefits accorded under Article 18(2) when the individual in question is neither a US citizen nor a green card holder.

Thus, the savings clause does not apply to an alien individual who is resident in the US only by reason of the substantial presence test. This rule effectively backs up the intent and operation of the qualifying distributions rule.

Even though the UK plan participant is a US resident and therefore generally taxable on worldwide income, the deferral of earnings rule would shield the UK plan participant from US tax on earnings building up in the UK plan.

Example 4 UK Plan Participant Also a US Resident Under Green Card Test

If the UK plan participant also happens to possess a US green card, things get more interesting. As in Example 3, one might conclude that because nothing in Article 18(2) turns on residence, the US must grant the benefits under the article even to a green card holder. One might further conclude that the deferral of earnings rule applies.

However, Article 1(5)(b) mentioned above (in Example 3) seems to give rise to a contrary inference. Recall that this exception from the savings clause is available only when the individual in question is *not* a US citizen or green card holder. Does this mean that a green card holder cannot claim the benefits of Article 18?

Two other sources shed some light on what may have been intended here. The 1996 US model treaty contains an Article 18 that is similar to the

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one in the US-UK treaty, and contains a similar, limited exception to the savings clause.

In contrast, the same provision in the proposed US-Italy treaty (1999) clearly extends the exception from the savings clause to all persons, whether or not they are citizens or green card holders. The technical explanation to this treaty, which has not yet entered into force, clearly states the US Trea-

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Snapshot

US, Netherlands Sign New Income Tax Protocol

American and Dutch tax authorities have signed a new protocol to the US-Netherlands income tax treaty, which includes several important changes. Those changes are summarized here.

- Modernization of existing treaty provisions designed to prevent the inappropriate use of the treaty (*e.g.*, treaty-shopping) to take into account economic developments and changes in treaty practices over the past decade. According to the US tax authorities, the new anti-abuse rules are "simpler, clearer and more effective."
- Introduction of exclusive residence-country taxation of certain intercompany dividends, which is the latest trend in US treaty practice. The elimination of withholding taxes on those dividends is supposed to help reduce barriers to investment between the two countries in both directions.
- Clarification of existing treaty rules on the tax treatment of investments made through partnerships. According to the US tax authorities, the clarifications should allow US and Dutch taxpayers greater flexibility in choosing the forms in which they do business.
- Coordination of US and Dutch tax rules governing pensions. The changes introduced by the new protocol should allow executives and others to pursue employment opportunities in either the US or the Netherlands without worrying about the unintended tax effects on their retirement benefits.

US tax authorities acknowledged that the Netherlands is an important source of inbound investment in the US and an important destination for outbound investment from the US, particularly as a platform for US multinational groups doing business in the EU.

In signing the new protocol, the US tax authorities acknowledged that the Netherlands is both an important source of inbound investment in the US and an important destination for outbound investment from the US, particularly as a platform for US multinational groups conducting operations and other activities in the member states of the European Union.

Look for details on the new protocol in a forthcoming issue of *Practical US/International Tax Strategies.*

Source: US Treasury Department Release No. JS-1221. ❑

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sury Department's intention to extend the benefits of the qualifying distributions rule to US citizens and green card holders.

Unfortunately for those searching for a reason for the difference, the technical explanation to the US model treaty contains an error that inverts the savings clause exception language of the model treaty itself. While the savings clause exception of the US model treaty quite clearly is limited to persons who are *not* green card holders or citizens, the technical explanation states that the qualifying distributions rule is "excepted from the saving clause with respect to permanent residents and citizens by virtue of paragraph 5(b) of Article 1."

If the employer is a US subsidiary of a UK parent, the rule merely operates to allow the US employer a deduction for a contribution to a foreign pension plan. If the employer is a US permanent establishment of a UK company, the rule operates both to allow the deduction and to allocate it to the permanent establishment under the principles of Article 7 of the treaty.

On balance, it seems to have been the US Treasury Department's aim to apply the savings clause to US citizens and green card holders, denying them the benefits of reliance upon the qualifying contributions rule.

Both the technical explanation of the US model treaty and the technical explanation of the proposed US-Italy treaty state that the pensions rule is available only to "visitors." While at first one might imagine that this choice of wording was meant to exclude US green card holders from the benefits of Article 18, as just noted, this is clearly not the case under the US-Italy approach.

It appears that the reference to visitors was meant to refer to the rule, common to all of these treaties, that limits the benefits of Article 18 to those cases where the employee had already been covered by the plan country pension plan before coming to the work state to work there. Thus, the visitors language sheds no light on whether the benefits of Article 18 should be extended to US green card holders or citizens.

It would appear that the US-UK treaty follows the US model and not the US-Italy approach, denying benefits in this Example 4. However, the savings clause analysis may be incomplete without considering the combined effect of the general savings clause in Article 1(4) and the US-UK treaty's definition of residence, particularly the limitation in Article 4(2).

The general savings clause of Article 1(4) applies to US residents only to the extent that they are treated as residents under Article 4. Article 4(2) provides that a US citizen or green card holder is a resident of the US "only if the individual has a substantial presence, permanent home or habitual abode in the United States."

(In addition, the individual must not be a resident of a third country for purposes of any treaty between that third country and the UK. The UK explanatory memorandum to the Treaty misstates this rule and seems to require that the individual *not* be a UK resident. *Explanatory Memorandum, The Double Taxation Relief (Taxes on Income) (The United States of America) Order 2002,* Annexe, Article 4.)

Although Article 4(2) was probably intended primarily to limit an individual's right to claim treaty benefits and, in fact, seems meant to be invoked only by the UK to deny treaty benefits, as worded it appears to override the savings clause in the cases in which it applies. However, note that it overrides the savings clause only for green card holders and not US citizens. While Article 4(2) by its terms applies to US citizens, the savings clause does not incorporate the residence rules of Article 4 when US citizens are at issue. All of this makes one wonder whether these myriad fine distinctions could possibly have been intended.

It appears that a UK plan participant who is a US green card holder and who has sufficient nexus to the US to be treated as a US resident under Article 4 may not be entitled to the benefits of Article 18. However, this conclusion is based on a negative inference taken from Article 1(5); the plain language of Article 18 appears to require the US to grant the benefits of that Article to any person described in it.

The usual purpose of a savings clause is to allow the US to tax a US citizen or resident, who is also a UK resident, as if the treaty did not exist. (*Joint Committee on Taxation Explanation (JCS-4-03) of Proposed Income Tax Treaty Between United States*

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and United Kingdom, March 3, 2003, at p. 10.) However, Article 18(2) purports to accord benefits to a UK plan participant whether or not he or she is a UK resident or a US resident, while Article 18(1) grants benefits only if the UK plan participant is, in fact, a US resident.

While a person must ordinarily be a resident of one of the treaty countries to claim benefits under the treaty, Article 18 is unique in that it permits a UK plan participant to claim benefits even if he or she is a resident only of the US and not a UK resident.

Thus, it can be argued that the savings clause should not be applied at all in the context of Article 18 because the US ceded its tax jurisdiction in the cases described there. This is one of several cases that should be addressed in further notes to the Treaty.

If the UK resident-US green card holder in question does not have sufficient US nexus to be treated as a resident under Article 4, it appears that he or she will be entitled to the benefits of the qualifying contributions rule, but possibly not to the benefits of the deferral of earnings rule.

Again, these conclusions are far from certain. In any event, this would seem to be the rare case, indeed. Article 18(2) applies only when the UK plan participant works in the US. In most cases, if not all of them, the exercise of US employment would probably be sufficient to create nexus under Article 4(2). Still, this kind of fact pattern is conceivable, as there is no requirement that the individual work in the US for any significant length of time.

One might at first suppose that any different outcome in the two cases under this example might be explained by the desire of the US not to accord benefits afforded under UK pension plans to individuals who have established strong contacts with the US. Perhaps the Treaty drafters expected that, in those cases, the US green card holder should be covered only by a US plan. Unfortunately, in many cases there may be no US plan.

In any event, as the following two examples illustrate, this rationale does not explain why US citizens are treated differently. The different results, if they are in fact different, seem to be explained more by oversight than by principled distinctions.

It appears that the employer deduction rule is available whether or not the savings clause applies to the individual in question. Whether this was intended is difficult to guess.

Example 5
UK Plan Participant Also a US Citizen

The operation of Article 18 as applied to UK plan participants who are US citizens appears to yield the same results as in Example 4, except when the UK resident/US citizen has no nexus in the US, within the meaning of Article 4(2). That fact alone does not remove him or her from the savings clause, which applies to US citizens regardless of residence. Nor does Article 1(5)(b) apply here; that exception from the savings clause is unavailable to US citizens.

The question arises whether the rule could generate double deductions for the same contribution in the UK and in the US. If the employer is a US subsidiary or permanent establishment of a UK parent, and if the UK parent actually funds the contribution, nothing in Article 18 appears to prevent both the UK parent and the US employer from claiming the deduction.

Thus, it appears that a US citizen who is covered by a UK pension plan, and comes to work for any period of time in the US, cannot claim the benefits of Article 18(2).

Ironically, it is easier to imagine a UK plan participant working intermittently in the US who "just happens" to be a US citizen than it is to imagine such a person who "just happens" to be a US green card holder.

Obtaining a green card is an affirmative and voluntary act, as well as a statement of intention to reside permanently in the US. On the other hand, citizenship may, in some cases, be largely a matter of birth over which the plan participant had no control.

(Given the significant penalties for relinquishing US citizenship, each year proposed to become more Draconian, it would be the rare US tax advisor that would lightly recommend that a US citizen to give up his or her citizenship.)

If anything, one might expect the qualifying

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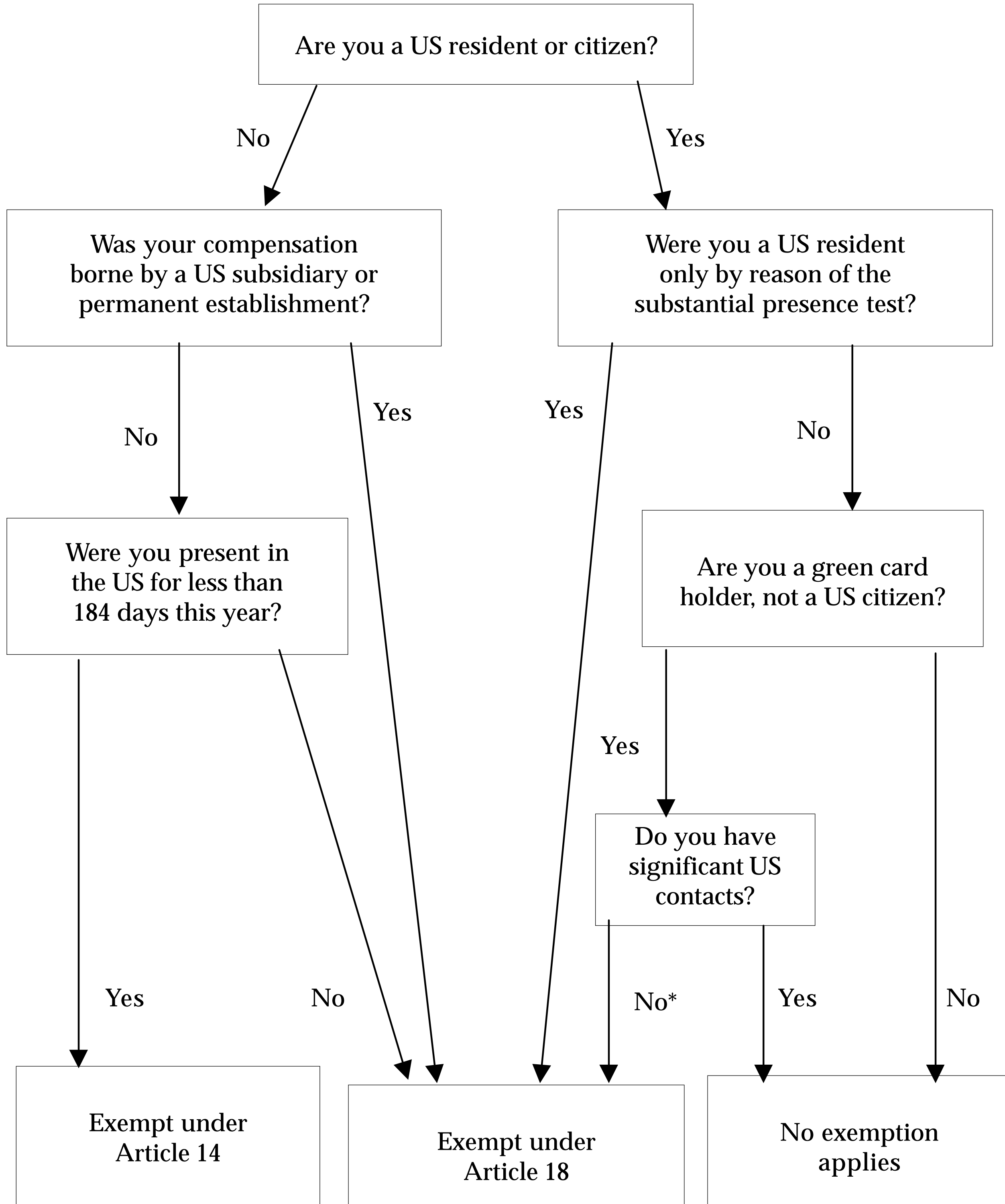

contributions rule to be available to the occasionally present US citizen, but not to the green card holder -- the opposite result from that which seems to be adopted by the Treaty. There does not seem to be any policy reason, in this context, to differentiate between US citizens and green card holders in the manner in which the Treaty apparently does. The difference may have been unintended. If so, it is difficult to guess what the intended results in these cases were.

Note that a US citizen, in some relatively narrow situations, may claim treaty benefits with respect to pensions under Article 18(5), described in the next example. However, Article 18(5) applies only when the US citizen works in the UK. It does not appear to cover days worked in the US.

Example 6 UK Plan Participant Who is a US Citizen Working in the UK

Unlike most of the previous examples, which can be reversed to posit a US plan participant working in the UK and benefiting from contributions to a US pension plan, this example operates in only one direction. Article 18(5) of the Treaty creates a very detailed and circumscribed rule intended to benefit a narrow class of persons caught up by the US insistence on taxing its citizens, wherever resident, on their worldwide income.

Article 18(5) extends the qualifying contributions rule to certain US citizens working in the UK. To qualify, the following requirements must be satisfied: (1) the individual must be a US citizen -- the rule apparently does not extend to green card holders; (2) the individual must be a UK resident (presumably under UK law, but perhaps also under the Treaty's residence test) (recall that Article 4 excludes from the definition of US resident a US citizen with no US contacts); (3) the individual must be working in the UK; (4) the income he or she earns from working in the UK must be taxable there; (5) the individual's compensation must be borne by a UK employer or permanent establishment; and (6) the individual must be a participant in a UK plan.

Apart from the special rule under Article 18(5), there is no rule in the Treaty that prevents the state from which an individual relocated from taxing contributions made to a plan established in the work country. (The suggestion to the contrary in "Shop Talk" is not explained.) Presumably, the drafters felt that the rule was not needed when the UK had been the home country, since the UK generally imposes tax only on a residence basis.

Astonishingly, when the Treaty was first published, it was apparent that the drafters had completely forgotten to turn off the savings clause in relation to Article 18(5). The effect was a nullity -- the benefits of Article 18(5) could never be available because of the savings clause being applicable. This technical error was remedied in a July 2002 protocol to the Treaty. One wonders whether, in light of the failure to coordinate Article 18 with the savings clause in a case where the intention was so obvious, the less obvious cases referred to in Examples 4 and 5 were overlooked.

Despite frequent acknowledgments that we live in a highly mobile society, treaty drafters did not conceive of a situation in which individuals actually move from place to place. The operative rules in Article 18, like those in the rest of the treaty, appear to be predicated upon the notion that people move only infrequently, and then stay put.

It is unclear why the rule of Article 18(5) was not extended to US green card holders. For most purposes of the Treaty, green card holders are treated identically to US citizens. It seems likely that, to the extent that the Treaty drafters gave this matter thought, they assumed a green card holder would not be a resident of, taxable in, and working in the UK. They probably imagined that because an individual applying for a green card must swear that he or she intends to reside permanently in the US, this circumstance could never occur.

However, people do change their minds. We have all seen cases in which a non-US citizen working in the US obtains a green card, only to return to his or her home country after a period of years. Indeed, the expatriation provisions in §877 of the Code specifically apply to this case, if the green card holder has been here at least eight years.

(Once again, while the natural expectation in

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this case would be for the green card holder to surrender his or her card, given the harsh rules of §877, this is a matter not to be undertaken lightly.)

Perhaps the drafters had more sympathy for the individual who just happens to be a US citizen than they did for one who affirmatively sought US green card status. However, if that were the case, the drafters' sympathies seem to have been the opposite in the context of Article 18(2), as noted in Examples 4 and 5.

The Treaty's failure to extend the benefits of Article 18(5) to green card holders who are resident in, and working in, the UK would appear to constitute a violation of the nondiscrimination article of the Treaty (Article 25(1)). In Rev. Rul. 91-58, 1991-2 C.B. 340, the Internal Revenue Service relied upon the nondiscrimination article to extend the benefits of the §911 exemption to a green card holder who worked in the UK, notwithstanding the fact that §911 generally applies only to US citizens working abroad.

The US-UK treaty does not work well when it is applied to peripatetic executives who split their time more or less evenly between two (or even more) countries and are covered by a pension plan in their original "home" country.

There is no indication that the nondiscrimination rules should not apply to a particular provision of the Treaty itself, and the nondiscrimination rules of the Treaty override the savings clause.

It is also unclear whether the US citizen must work solely in the UK, or may work in other countries (including the US) during the period that he or she is covered by a UK plan. If the UK resident travels to the US during a given year and works partly in both countries, one might suppose that Article 18(2) would be available to him or her with respect to days worked in the States.

However, as noted in Example 5, it appears that the benefits of Article 18(2) do not extend to US citizens. If so, the end result is quite odd: a US citizen who spends time working in both the UK and the US would appear able to claim Article 18 benefits for the days worked in the UK, but not for the days worked in the US.

What all of this suggests is that, despite the frequent acknowledgments that we live in a highly mobile society, the Treaty drafters did not conceive of a situation in which individuals actually move from place to place. The operative rules in Article 18, like those in the rest of the Treaty, appear to be predicated upon the old-fashioned notion that people move only infrequently, and then stay put.

Conclusion

Pondering the six examples above, one wonders whether there might have been a much simpler, more direct way to accomplish what the Treaty is trying to accomplish in Article 18. To begin with, the Treaty should have adopted the approach of the proposed US-Italy treaty, and waived the application of the savings clause in its entirety to all of Article 18. Having done so, if the drafters felt there were some cases not deserving of benefits under Article 18, those cases could be set forth clearly in the text of the article itself.

With some exceptions, the Treaty should work fairly well for individuals who transfer from one country to the other and work for a period of time only in the new country. However, the Treaty does not work well when it is applied to peripatetic executives who split their time more or less evenly between two (or even more) countries and are covered by a pension plan in their original "home" country. Because this is a relatively common phenomenon, it is unfortunate that the Treaty was not drafted more flexibly. In this respect, at least, the new Treaty rules applicable to pensions seem dated even before they actually took effect.

Article 18 could also have benefited by the addition of a general rule for cases not explicitly covered by its terms. The last sentence of Article 26(3) of the Treaty, relating to mutual agreement procedures (otherwise known as "competent authority relief"), provides that the competent authorities may "consult together for the elimination of double taxation in cases not provided for in this Convention." As relief from the double taxation of pension contributions and payouts seems to be the unifying theme of Articles 17 and 18, a specific acknowledgement that there might be cases of double taxation not covered by the articles would have been helpful and appropriate. ❑

Kim Blanchard is a partner in the New York office of Weil, Gotshal & Manges LLP, concentrating in international transactions. Ms. Blanchard can be contacted by email at kim.blanchard@weil.com, or by telephone at 212-310-8799.

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ties agree publicly that e-commerce is not so different from traditional forms of business as to justify the implementation of a new tax system, the states have taken a rational approach to the issue.

Computer Servers

A computer server is defined as a machine on which specific software is run. When connected to the Internet, a server or network of servers enables businesses to perform a variety of tasks, such as storing and updating customer records, performing financial and tax calculations for business, and accessing and sending information to third-party users. Internet computers servers provide data, services, and functionality through a digital network to multiple users.

Unquestionably, as noted above, it is now possible to operate a highly profitable global business over the Internet using only a computer server.

The permanent establishment analysis requires the existence of a tax treaty, while the effectively connected income or "ECI" analysis does not.

Co-Location Agreements

For purposes of the discussion in this article, Internet server co-location arrangements (the kind that creates both a taxable presence and a PE) refer to the lease of a "co-location space." Co-location space refers to a specific physical area within a co-location facility.

Leased co-location space can consist of either of a private cabinet or a private or community cage

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Multilateral Issues

US, UK, Canada, and Australia Launch New Initiative on "Abusive" Transactions

The heads of the national tax administrations of Australia, Canada, the United Kingdom, and the United States have started discussions about forming a "joint task force" to increase their collaboration and coordinate more information about "abusive" tax transactions.

In announcing the new initiative, the tax commissioners said that they share a number of common challenges with respect to abusive tax transactions. While the tax administrations operate primarily within their own borders, the authorities pointed out that many abusive tax transactions use strategies that cross borders, and many of the promoters of abusive transactions operate globally without regard to national boundaries.

According to the tax authorities, setting up the multilateral joint task force would enable the four countries to:

- share expertise, best practices, and experiences in the field of tax administration to identify and better understand abusive tax transactions and emerging schemes, as well as those who promote them;
- exchange information about specific abusive transactions, their promoters, and their investors, within the framework of the countries' existing bilateral tax treaties; and
- carry out their individual abusive tax transaction enforcement activities more effectively and efficiently.

According to the head of the US tax authority, Internal Revenue Service Commissioner Mark Everson, "This is an unprecedented step in the battle against the plague of abusive tax transactions."

The commissioners of the four tax administrations have agreed to meet in Washington within the next month to finalize their plans to launch this new initiative.

Source: US Treasury Department Release No. IR-2004-35, March 15, 2004. ❑

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(ranging in size) in which a computer server is physically stored and connected to the Internet. A co-location arrangement grants a business the right to operate computer servers connected to the Internet with minimal interruption.

Internet Server Farms

For any reader who is still convinced that computer server storage and the computer server storage industry remain ethereal concepts in cyberspace, consider the advertisements of AboveNet Communications *(http://www.above.net)* and Equinix (*http://www.equinix.com*), both well-known co-location service vendors and operators of Internet "server farms."

Operating a computer server on a 24-hour, 365-day basis clearly constitutes a regular and considerable activity, which can yield business profits from a fixed location. The law does not require the presence of a human being in the mix before the point of taxation is reached.

Each vendor boasts of 24-hour, 365-day staffed physical security, cyber security, full motion surveillance cameras, bulletproof exterior walls, individually locked cages, uninterruptible power supply ("UPS"), superior air conditioning, fire detection and suppression systems with built-in redundancies (*i.e.*, back ups), and seismically compliant (*i.e.*, earthquake proof) buildings that lack windows. In addition, biometric hand geometry readers are used to screen visitors.

That is a pretty impressive array of tangible, physical assets for something that is believed to exist only in cyberspace. In your mind's eye, picture a miniature maximum security condominium (the size of a 10 feet by 10 feet closet). If you are still unconvinced of the "physicality" of an Internet server farm, take a tour of one of the facilities. Perhaps it's too bad that these companies are not involved in the assisted-living business.

Location, Location, Location

By the way, it does matter where an Internet computer server is geographically situated. Do you really think you are going to find a facility like the one described above in the Cayman Islands?

Some tax practitioners continue to assert that it does not matter where a computer server is located, as long as it is connected to the Internet. This view could not be more wrong. Internet computer servers to need be connected to other infrastructure service providers to operate. Arguably, the best of these providers (*e.g.*, telecommunications) are in North America. In fact, AboveNet Communications, for example, has six data center facilities located in North America.

A computer server located in a customer's home country means faster access and faster services for users connecting to the Internet in that country. Some companies intentionally choose the US over other countries as the place to situate key Internet computer servers. A computer server located in the US still provides higher reliability, faster networks, and lower costs.

Thus, when considering co-location facilities in countries other than the US, the trade-offs among performance, cost, and reliability still favor the US over perhaps all other countries (despite the drama provided by California's electricity "shortages" last year).

A co-location agreement will get you a room in a physically secure facility, but no ocean view. You can store your computer server there and make money operating it on a 24-hour, 365-day basis. As most of us know, it is entirely possible to operate a business globally over the Internet with only a computer server and make money.

Traditionalism

The foregoing analysis of the facts as they are today seems to render moot the traditional US tax analysis. For non-US persons (companies, partnerships, *etc.*), when evaluating your US tax exposure, the question you must consider first is whether your activities generate income that is effectively connected with a US trade or business. Then, you must consider whether your operations constitute a PE within the US. Each analysis is independent of the other and either one can trigger the imposition of US tax liability.

A low level of activity is all that is required to conclude that a foreign (*i.e.*, non-US) business is engaged in a US trade or business. All activities that are considerable, continuous, and regular will be treated as effectively connected with a US trade or business. Continuous is defined as day-to-day activity, rather than a sporadic activity. Thus, under this analysis, a consider-

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able (as opposed to minimal) business activity must occur regularly, rather than irregularly.

The PE analysis requires the existence of a tax treaty, while the effectively connected income or "ECI" analysis does not. A foreign business, without treaty protection, is subject to US tax on its income that is effectively connected with a US trade or business.

The ECI test has a lower threshold than the PE test because there is no requirement that the US trade or business have a fixed place of business in the US. If it is determined that a foreign business is engaged in a US trade or business and has income that is effectively connected with that business, it is only necessary to determine whether the foreign company also has a PE in the US if a tax treaty exists between the country of residence of the foreign company and the US.

The purpose of the PE requirement is to determine a particular point in time when a foreign business has established a sufficient taxable presence or connection in a country to entitle that jurisdiction to tax the business profits generated from its transactions.

Existentialism

Under the revised OECD model tax treaty, a PE is defined as a "fixed place of business through which the business of an enterprise is wholly or partly carried on." The June 1998 OECD commentary to Article 5 of the model treaty states the essential characteristics of a PE are:

1) the existence of a place of business;
2) fixed in a specific location with a certain degree of permanence; and
3) the trade or business of the enterprise is carried on through this fixed place of business.

The existence of a place of business requirement is met if any premises, facilities, or installations of the entity have been used to carry on the business of the enterprise, whether or not they were used exclusively for that purpose. Further, a place of business may also exist where no premises are available or required for carrying on the business, but the enterprise must have a certain amount of space at its disposal. Finally, it is irrelevant whether the facilities available for use by the enterprise are owned or rented.

To satisfy the requirement that a place of business be fixed, there must be a link between the place of business and a specific geographical point, and it must not be temporary in nature or set up for a temporary purpose. Stated otherwise, the place of business must be established at a distinct place and with a certain degree of permanence. Once the elements of a PE have been met, the enterprise must have business profits associated with the PE before the tax authorities will assess tax against the foreign enterprise.

Under the traditionalists' analysis, storing and operating an Internet computer server in a leased co-location space results in both a US trade or business and a PE. Operating a computer server on a 24-hour, 365-day basis clearly constitutes a regular and considerable activity, which can yield business profits from a fixed location. Surprisingly, the law does not require the presence of a human being in the mix before the point of taxation is reached.

Interestingly, it is widely assumed by tax practitioners that businesses today can get around potential PE problems by entering into web-hosting contracts. Web-hosting contracts generally do not give the business owning the website any right to a particular space or control over the operation of a computer server, since it is not at the disposal of the business. Consequently, a fixed place of business does not exist.

Existentialism aside, according to the US Supreme Court, there are two different standards of business activity nexus -- one for the Due Process Clause of the US Constitution and one for the Commerce Clause.

However, if the foreign business has control over the computer server, there is a physical presence and a PE may exist.

Taxable Business Nexus

Existentialism aside, according to the US Supreme Court, there are two different standards of business activity nexus -- one for the Due Process Clause of the US Constitution and one for the Commerce Clause.

If you are worried about your exposure to US income tax liability, then you should take notice of the Due Process Clause and the jurisprudence it has spawned. The Due Process

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Clause has been interpreted as requiring purposeful direction of activity into an American state without regard to physical presence. If you are worried about sales tax liability, then you should pay attention to the jurisprudence under the Commerce Clause, which has been interpreted to require physical presence.

It would be prudent to conclude that co-location arrangements result in a taxable presence in the American state in which the server is physically located, regardless of how the arrangements are treated for federal or national tax purposes.

The fact that an Internet server creates a taxable presence, for US tax purposes, can be inferred from collateral legislation. Under H.R. 2526 (one of nine Internet tax moratorium bills introduced in 2001), the use of a computer server within a state would not constitute physical presence in that state. H.R. 2526 stalled in the US Congress in 2002, leaving the states free to assert taxable business nexus over Internet computer servers located within their borders.

It remains to be seen where other countries land on this debate. For example, in Portugal and Spain, market accessibility -- such as carrying on a business through a website (let alone a computer server) -- can constitute a PE. Unofficially, the Japanese tax authorities have suggested that the presence of a computer server in Japan might give rise to a PE by analogizing a computer server to a vending machine. Italy has taken the position that an unstaffed "smart server" (a server that performs actions similar to those performed by humans) may be sufficient to create a PE. France presumes that, absent human activity, a computer server does not give rise to a PE unless the computer server operates autonomously. Stated otherwise, an unstaffed server does not give rise to a taxable PE unless the server is extremely "smart".

In sum, it is now clearly possible to operate a business globally over the Internet using only a computer server. Internet server co-location arrangements are one legal mechanism for engaging in this kind of business activity. Finally, it would be prudent to conclude that co-location arrangements result in a taxable presence in the American state in which the server is physically located, regardless of how the arrangements are treated for federal or national tax purposes. ❑

Hannah M. Terhune (LL.M. in Taxation, New York University) specializes in tax and securities law. She has served as a Lecturer in Taxation at the Columbus School of Law, The Catholic University of America, and at the School of Management, George Mason University. GreenTraderTax.com consults traders on tax solutions, reviews or prepares their tax returns, and sets up business entities and retirement plans. GreenTraderTax.com also specializes in hedge fund creation and management, and offers traders its own line of tax guides and trade accounting software. For more information, visit www.greentradertax.com or call 212-658-9502.

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