TREASURY DEPARTMENT TECHNICAL EXPLANATION OF THE AGREEMENT BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF FINLAND FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME AND ON CAPITAL GAINS SIGNED AT HELSINKI ON SEPTEMBER 21, 1989

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INTRODUCTION

This Convention is designed to avoid double taxation and prevent fiscal evasion with respect to taxes on income and capital. It was negotiated on the basis of the revised U.S. Model Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital published in June 1981 (hereafter referred to as the "U.S. Model") and a draft provided by Finland. In general, both the U.S. Model and the Finnish draft reflect the revised Model Double Taxation Convention on Income and on Capital published by the Organization for Economic Cooperation and Development (OECD) in 1977 (hereafter referred to as the "OECD Model"). This Convention replaces the Convention between the United States and Finland, signed on March 6, 1970 (the "1970 Treaty").

The technical explanation is an official guide to Convention. It reflects policies behind particular Convention provisions, as well as understandings reached with respect to the interpretation and application of the Convention.

TABLE OF ARTICLES

ARTICLE 1
Personal Scope

This Article identifies the persons who come within the scope of the Convention (hereafter referred to as "the Treaty") and establishes the relationship between it and domestic law.

Paragraph 1 provides that the Treaty applies to residents of one or both of the Contracting States, except where the Treaty specifically provides otherwise. The term "resident of a Contracting State" is defined in Article 4 (Residence). The exception refers to certain cases in which the Treaty may also apply to residents of third countries because of their relationship to a resident of a Contracting State or because they are citizens of a Contracting State. For example, under paragraph 5 of Article 10 (Dividends), the Treaty covers certain dividends paid by residents of third countries. Similarly, Article 26 (Exchange of Information) may apply to residents of third countries.

Paragraph 2 provides that the Treaty shall not restrict any benefit provided by the laws of either Contracting State or by any other agreement between the Contracting States. Thus, if a deduction would be allowed in computing the taxable income of a Finnish resident under the Internal Revenue Code ("Code"), such a deduction is generally available to him in computing taxable income under the Treaty. A taxpayer, however, may not make inconsistent choices between Code and Treaty rules. In no event are the rules of the Treaty to increase overall U.S. tax liability from what it would be if there were no Treaty. It follows that a right to tax under the Treaty cannot be exercised unless that right also exists under the Code.

Paragraph 3 contains the "saving clause" under which each Contracting State reserves the right to tax a person who is treated as a resident under its taxation laws (except where such person is determined to be a resident of the other Contracting State under the provisions of paragraph 2 or 3 of Article 4 (Residence)), and its citizens, as if the Treaty had not come into effect. Therefore, under this paragraph, the United States reserves the right to tax an alien who is a "lawful permanent resident" in the United States in accordance with the immigration laws but is resident in a third country, as if the Treaty had not come into effect, although such an alien may not be considered a resident under Article 4 (Residence). The Contracting States also reserve their right to tax a former citizen whose loss of citizenship had as one of its principal purposes the avoidance of tax but only for a period of 10 years following such loss of citizenship. Such former

citizens of the United States are taxable in accordance with section 877 of the Code.

Paragraph 4 sets forth certain exceptions to the application of the saving clause where other provisions of the Treaty reflect overriding policies. Without these exceptions, the provisions would not serve their intended purpose. For example, under paragraph 4(a), the saving clause does not affect the benefits provided under paragraph 2 of Article 9 (Associated Enterprises) relating to correlative adjustments of tax liability, or the benefit of paragraphs 1(b) and 4 of Article 18 (Pensions, Annuities and Child Support) relating to social security payments and payments for child support. The benefits provided in Articles 23 (Elimination of Double Taxation), 24 (Non-Discrimination), and 25 (Mutual Agreement Procedure) are also available, notwithstanding the saving clause, to residents and citizens of the Contracting States.

In a second category of exceptions, found in paragraph 4(b), the saving clause will not override benefits conferred by a Contracting State upon residents who are not citizens of, or lawful permanent residents in, that State. A "lawful permanent resident," in the United States, is defined in section 7701 of the Code and refers to an individual who has the status of having been lawfully accorded the privilege of residing permanently in the United States as an immigrant in accordance with the immigration laws (i.e., a "green card holder"). An individual need not be a lawful permanent resident to be considered a resident for tax purposes. See section 7701(b) of the Code. This second category of exceptions covers the benefits conferred under Articles 19 (Government Service), 20 (Students and Trainees), and 27 (Diplomatic Agents and Consular Officers).

ARTICLE 2
Taxes Covered

Paragraph 1 designates the existing taxes to which the Treaty shall apply. In the case of the United States, these are the federal income taxes imposed by the Code, but excluding the accumulated earnings tax, the personal holding company tax, Federal unemployment taxes and social security taxes. The Treaty also applies to excise taxes on insurance premiums paid to foreign insurers (Code section 4371) and with respect to private foundations (Code sections 4940 and 4948). The excise tax on insurance premiums is covered only to the extent that the risks are not reinsured, directly or indirectly, with a person not entitled to relief from such tax.

United States taxes not generally covered by the Treaty include the estate, gift, and generation skipping transfer taxes, and the Windfall Profits Tax.

In the case of Finland, the covered taxes are the state income and capital tax, the communal tax, the church tax and the tax withheld at source from non-residents' income. The covered U.S. and Finnish taxes are referred to in the Treaty as "United States tax" and "Finnish tax," respectively.

Paragraph 2 provides that the Treaty shall also apply to any taxes imposed subsequent to September 21, 1989, which are identical or substantially similar to the then existing taxes covered by the Treaty. The competent authorities agree to notify each other of any significant changes in

their respective tax laws, and of significant official published material concerning the application of the Convention.

Notwithstanding the foregoing, for purposes of Articles 24 (Non-Discrimination) and 26 (Exchange of Information and Administrative Assistance), as provided in those Articles, the Treaty will also apply to taxes of every kind and description imposed by a Contracting State. In the case of Article 24, such expanded coverage also includes taxes imposed by political subdivisions and local authorities.

A note dealing with two issues relevant to the application of the Treaty was exchanged at the time of the signing of the Treaty.

Paragraph 1 of the note deals with the application of the Finnish communal tax (which is a covered tax under subparagraph (a)(ii) of paragraph 1 of Article 2 (Taxes Covered)) in a situation where an enterprise of the United States maintains more than one permanent establishment in Finland. The note states the understanding that the provisions of Article 7 (Business Profits) will not preclude Finland from determining the portion of the aggregate profits of the U.S. enterprise, which are attributable to each permanent establishment by an apportionment method customarily used in Finland for that purpose. The note goes on to state, however, that the result of any such apportionment will be in accordance with the principles of Article 7.

The note also indicates the understanding that the United States intends to develop procedures which can be administered without undue burden, for applying the limitation on the coverage of the excise taxes on insurance premiums provided for in the last sentence of subparagraph (b) of paragraph 1 of Article 2 (Taxes Covered).

ARTICLE 3
General Definitions

Paragraph 1, like paragraph 1 of the U.S. Model, defines the principal terms used throughout the Treaty. Unless the context otherwise requires, the terms defined in this paragraph have a uniform meaning throughout the Treaty. A number of important terms, however, are defined in other articles. For example, the terms "resident of a Contracting State" and "permanent establishment" are defined in Articles 4 (Residence) and 5 (Permanent Establishment), respectively, and the terms "dividends," "interest," and "royalties" are defined in Articles 10 (Dividends), 11 (Interest), and 12 (Royalties).

The definitions of the terms “person,” “company,” “enterprise of a Contracting State," and "international traffic" are similar to the definitions in the U.S. Model. A “person” is defined to include an individual, an estate, a trust, a partnership, a company, and any other body of persons. The term “company” means any body corporate or an entity which is treated as a body corporate for tax purposes.

An "enterprise of a Contracting State" is defined to mean an enterprise carried on by a resident of a Contracting State.

The term "international traffic" means any transport by a ship or aircraft, except when such transport is solely between places within a Contracting State.

With respect to the United States, the term "competent authority" means the Secretary of the Treasury or his delegate. Currently, such role is delegated to the Tax Treaty and Technical Services Section of the Office of Assistant Commissioner (International) at the Internal Revenue Service. With respect to Finland, the term means the Ministry of Finance or its authorized representative.

A "national" of the United States is defined as a citizen of the United States as well as all legal persons, partnerships and associations deriving their status as such from the laws in force in the United States. A "national" of Finland is defined as an individual possessing the nationality of Finland and all legal persons, partnerships and associations deriving their status as such from the laws in force in Finland. In the U.S. Model, a "national" is defined in Article 24 (Non-Discrimination). However, since the term is used in other Articles as well (e.g., Articles 19 (Government Service) and 25 (Mutual Agreement Procedure)), the definition is included here among the general definitions in Article 3. The U.S. Model defines a national of the United States as a citizen. The addition to the definition of legal persons may be significant in relation to paragraph 1 of Article 24 (Non-Discrimination), which assures that nationals of one Contracting State will be subject to no less favorable treatment in the other Contracting State than the latter accords its own nationals.

The term "United States" is defined to mean the United States of America, but does not include Puerto Rico, the Virgin Islands, Guam, or any other U.S. possession or territory. Although the Treaty does not explicitly include the continental shelf in the definition of the United States, by virtue of Section 638 of the Code, it is considered to be covered within the definition of the United States for purposes of the Treaty.

The term "Finland" means the Republic of Finland and, when used in a geographic sense, means the territory within which Finnish tax law is in force.

Paragraph 2 provides that, in the case of a term not defined in the Treaty, the domestic tax law of the Contracting State applying the Treaty shall control, unless the context in which the term is used requires a definition independent of domestic tax law or the competent authorities agree to a common meaning of the term pursuant to the provisions of Article 25 (Mutual Agreement Procedure). The term "context" refers to the purpose and background of the provisions in which the term appears. An agreement by the competent authorities with respect to the meaning of a term used in the Treaty would supersede any conflicting meanings in the domestic laws of the Contracting States.

ARTICLE 4
Residence

Article 4 sets forth rules for determining the residence of individuals, companies, and

other persons for purposes of the Treaty. A definition of residence is important because, for the most part, only residents of the Contracting States may claim benefits under the Treaty. The Treaty definition is, of course, exclusively for purposes of the Treaty.

Paragraph 1 lists a number of criteria which may be used under the laws of a Contracting State to determine residence, such as domicile, residence, place of management, or place of incorporation. Residents of the United States generally include U.S. citizens and aliens who are considered U.S. residents under section 7701(b) of the Code. A U.S. citizen or an alien lawfully admitted for permanent residence in the United States, however, will not be treated as a resident of the United States for purposes of the Treaty, unless he has a substantial presence, permanent home, or habitual abode in the United States. Therefore, a U.S. citizen (or a lawful permanent resident in the United States) residing in a third country will not be considered a resident of the United States entitled to the benefits provided by the Treaty, if he has neither a substantial presence, permanent home nor habitual abode in the United States.

Paragraph 1(a) provides that a person who is liable to tax in a Contracting State only with respect to income from sources in that Contracting State is not considered a resident of that Contracting State for purposes of the Treaty.

Paragraph 1(b) of this Article also provides that a partnership, estate, or trust is a resident of a Contracting State only to the extent that the income derived by such person is subject to tax in such Contracting State as the income of a resident. For example, under United States law, a partnership is never, and an estate or trust is often not, taxed as such. Under the Treaty, income received by a partnership, estate, or trust will be treated for purposes of the Treaty as income received by a resident of the United States only to the extent such income is subject to tax in the United States as the income of a resident. Thus, for United States tax purposes, the question of whether income received by a partnership is received by a resident will be determined by the residence of its partners rather than by whether the partnership is resident in the United States by reason of engaging in a trade or business here. To the extent the partners are subject to United States tax as residents of the United States, the income received by a partnership will be treated as income received by a resident of the United States. Similarly, the treatment of income received by a trust or estate will be determined by the residence of the person subject to tax on such income, which may be the grantor, the beneficiaries or the trust or estate itself, as the case may be.

The fact that a charitable organization or pension fund is exempt from tax in the country in which it is otherwise resident is not to be construed to deny such organization or fund resident status under the Treaty.

Paragraph 2 provides a series of tie-breaking rules for assigning a residence to an individual who, under paragraph 1, would be a resident of both countries. The first test is where the individual has a permanent home. If this test is inconclusive because the individual has a permanent home in both countries, his residence is in the Contracting State where his center of vital interests lies, i.e., the Contracting State with which his personal and economic relations are closer. If such a center cannot be determined, or if the individual has a permanent home in neither country, residence is where the individual has an habitual abode. If he has an habitual abode in both countries or in neither of them, he is deemed to be a resident of the State of which he is a

national. Should the individual be a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question of residence by mutual agreement.

Paragraph 3 provides that if, under paragraph 1, a person other than an individual is a resident of both Contracting States, the competent authorities shall attempt to agree on a single residence for such person. This provision applies to persons such as trusts and estates. Dual residence of corporations cannot arise under the Treaty because the United States and Finland apply the same test to determine corporate residence.

ARTICLE 5
Permanent Establishment

This Article defines the term "permanent establishment," which is relevant particularly to the taxation of business profits under Article 7 (Business Profits). This Article is essentially the same as Article 5 (Permanent Establishment) of the U.S. Model.

Paragraph 1 defines the term "permanent establishment" as a fixed place of business through which the business of an enterprise is wholly or partly carried on.

Paragraph 2 provides an illustrative non-exhaustive list of fixed places of business which constitute a permanent establishment. The list includes a place of management, a branch, an office, a factory, a workshop, and a mine, an oil or gas well, or any other place of extraction of natural resources.

Paragraph 3 provides that a building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months. It further provides that the use of an installation or drilling rig or ship for the exploration or exploitation of natural resources in a Contracting State will constitute a permanent establishment in that Contracting State only if such use is for more than 12 months.

Under both rules of paragraph 3, the 12-month period begins when work physically commences within the territory of the Contracting State. A series of contracts or projects which are interdependent both commercially and geographically are to be treated as a single project for the purpose of applying the twelve-month test. If the 12-month test is exceeded, the site, project, or activity constitutes a permanent establishment from the first day.

Paragraph 4 lists a number of exceptions to the general rule that a fixed place of business through which the activities of an enterprise are carried on constitutes a permanent establishment. This paragraph is the same as the comparable paragraph in the U.S. Model.

Paragraphs 5 and 6 apply to the use of agents. Under paragraph 5, a dependent agent acting on behalf of an enterprise who habitually exercises an authority to conclude contracts in the name of the enterprise is deemed to constitute a permanent establishment of that enterprise except to the extent that his activities are limited t6 those mentioned in paragraph 4, which would not constitute a permanent establishment when carried on at a fixed place of business. Paragraph 6

provides that if an enterprise of one Contracting State makes use in the other Contracting State of a broker or other agent of independent status acting in the ordinary course of business, it will not thereby be considered to have a permanent establishment in that other State.

Paragraph 7 provides that the fact that a company which is a resident of one Contracting State either controls or is controlled by a company which is a resident of the other Contracting State is not in itself relevant in determining whether a company has a permanent establishment in the other Contracting State. What is relevant is whether one company carries on for the other an activity which, within the provisions of the Article, would make the first company a dependent agent of the other. It follows that the same rules apply to two or more subsidiaries of the same company.

ARTICLE 6
Income from Immovable (Real) Property

Paragraph 1 of this Article provides that income derived by a resident of a Contracting State from immovable property, including income from agriculture or forestry, which is situated in the other Contracting State may be taxed in that other State. This right, however, is not exclusive; the rule simply confirms that the situs State has the primary right to tax such income regardless of whether the income is derived through a permanent establishment in that State.

Paragraph 2 provides that the term "immovable property" is to be defined under the laws of the Contracting State in which the property in question is situated. It goes on to specify certain types of property which, regardless of the internal law definitions, are to be included in the Treaty definition of real property.

Included within the term is property accessory to immovable property, livestock and equipment used in agriculture or forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments (e.g., royalties) as consideration for the working of or the right to work mineral deposits, sources and other natural resources (e.g., oil and gas wells). Ships, boats, and aircraft are not regarded as immovable property.

Paragraph 3, which is identical to paragraph 3 in the U.S. Model, provides that the basic rule in paragraph 1 applies to income derived from the direct use, letting, or any other use of immovable property.

Paragraph 4, not found in the U.S. Model, was inserted at the request of Finland. It provides that where the ownership of shares or other corporate rights in a company entitles the owner to the enjoyment of immovable property held by the company, any income from the direct use, letting or use in any other form of this right of enjoyment may be taxed in the Contracting State in which the immovable property is situated. This rule is intended to clarify that such income is to be treated as income from immovable property and not as income from movable property. The principal application of this provision is expected to be with respect to the taxation of income from the rental of cooperative apartments by a shareholder in the cooperative, though

it would apply to commercial property as well. Under paragraph 5, these rules apply to income from a right of enjoyment of an enterprise and to income from such a right used for the performance of independent personal services.

Paragraph 5, which is identical to paragraph 4 of the U.S. Model, provides that the rules of this Article apply to the income from immovable property of an enterprise or from property used for the performance of independent personal services.

The provision in the U.S. Model providing for a binding election to be taxed on a net basis was deleted. Such an election is available under U.S. law, and the Finnish tax on income from real property generally applies on a net basis in any event. Though there are some exceptions to this rule under Finnish law with respect to certain forestry and agricultural property, foreign ownership of such property is very restricted.

ARTICLE 7
Business Profits

This Article provides rules for the taxation by a Contracting State of income from business activity carried on in that State by a resident of the other State. Throughout this Article, at the request of Finland, the term "profits" is used in place of the term "business profits" used in the U.S. Model. No difference in meaning is intended.

Paragraph 1 provides that the profits (as defined in paragraph 7) of an enterprise of one Contracting State shall be taxable only in that Contracting State, except to the extent that such profits are attributable to a permanent establishment (as defined in Article 5 (Permanent Establishment)) through which the enterprise carries or carried on business in the other Contracting State. The reference to a prior permanent establishment ("or carried on") makes clear that a Contracting State in which a permanent establishment existed has the right to tax the profits attributable to that permanent establishment, even if there is a delay in the receipt or accrual of such profits until after the permanent establishment has been terminated. This rule is consistent with section 864(c)(6) of the Code. However, the reference to a prior permanent establishment is not intended to incorporate the rules provided by section 864(c)(7) of the Code.

Paragraph 2 provides that the profits to be attributed to a permanent establishment are those which it might be expected to earn if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions. The profits attributed under paragraph 2 may be from sources within or without a Contracting State. Thus, items of income described in section 864(c)(4)(B) of the Code which are attributable to a permanent establishment in the United States may be subject to tax by the United States. Under the Treaty the limited "force of attraction" rule in section 864(c)(3) of the Code does not apply for U.S. tax purposes.

Paragraph 3 provides that there shall be allowed as deductions those expenses incurred for the purposes of the permanent establishment, whether incurred in the State where the permanent establishment is located or elsewhere. The deductible expenses include a reasonable

allocation of administrative expenses, and other expenses incurred for the purposes of the enterprise as a whole or the part thereof which includes the permanent establishment. Unlike the U.S. Model, the paragraph does not refer specifically to research and development expenses arid interest. It is understood, however, that the phrase "other expenses" is to be interpreted as including these items of expenditure.

Paragraph 4 is the same as paragraph 4 of Article 7 of the U.S. Model. It provides that the mere purchase by a permanent establishment of goods or merchandise for the enterprise shall not result in profits being attributed to the permanent establishment.

Paragraph 5, which repeats paragraph 5 of the U.S. Model, provides that the profits to be attributed to the permanent establishment include only the profits derived from the assets or activities of the permanent establishment, and the same method for determining profits attributable to a permanent establishment shall be used each year unless there is good and sufficient reason to change. This assures continuous and consistent tax treatment.

Paragraph 6 provides that where profits include items of income dealt with separately in other articles of the Treaty, then the provisions of those separate articles override the provisions of this Article. Thus, for example, the taxation of income of shipping and aircraft companies dealt within Article 8 (Shipping and Air Transport) is governed by that Article and not by this Article. In other cases-for example, Articles 10 (Dividends), 11 (Interest), and 12 (Royalties) the terms of the Article specifically provide that where the income derived by a resident of a Contracting State is attributable to a permanent establishment of that resident in the other Contracting State, then the provisions of this Article shall apply.

Paragraph 7 provides a definition of "profits." The term is defined to mean income derived from any trade or business, including rentals of tangible personal property. At the request of Finland, the term does not include the rental or licensing of motion pictures or tapes used for radio or television broadcasting. Such payments are included in the definition of "royalties" in Article 12 (Royalties) and are exempt from the source country withholding tax, unless the beneficial owner of the royalties carries or carried on business in that country through a permanent establishment. Thus, for example, income derived by a resident of the United States from the rental of tangible personal property or from the rental of cinematographic films to a person in Finland will not be subject to tax in Finland unless that lessor has a permanent establishment in Finland to which such income is attributable.

ARTICLE 8
Shipping and Air Transport

Paragraph 1 provides that profits of an enterprise of one of the Contracting States from operating ships or aircraft in international traffic shall be taxable only in that Contracting State. International traffic is defined in paragraph 1(g) of Article 3 (General Definitions).

By virtue of paragraph 6 of Article 7 (Business Profits), profits of a resident of one Contracting State that are exempt under paragraph 1 from tax in the other Contracting State

remain exempt even if the resident has a permanent establishment in that other State.

This provision is subject to the saving clause of paragraph 3 of Article 1 (General Scope). Thus, the United States may tax income from international traffic derived by a resident of Finland without regard to this Article if such resident is a citizen of the United States.

Paragraphs 2 and 3 clarify what income is to be considered profits from the operation of ships or aircraft. Paragraph 2 states that income from the operation of ships or aircraft in international traffic includes profits from the rental of ships or aircraft if such rental profits are incidental to other profits described in paragraph 1. In these cases the lessee of the property need not be a resident of a Contracting State. For example, if an international airline which is a resident of one Contracting State has excess equipment for several months and leases an aircraft which is not required by it during that period to another airline, the rental profits of the lessor are not subject to tax by the other Contracting State, regardless of the state of residence of the lessee. If, however, the lessor is not engaged in the operation of ships or aircraft in international traffic, and, therefore, the lease income is not incidental to such activities, the income is not covered by this Article. It would be business profits, subject to the rules of Article 7 (Business Profits).

Paragraph 3 states that 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 to transport goods or merchandise in international traffic are taxable only in the State of residence of the enterprise.

Paragraph 4 provides that the provisions of paragraphs 1 and 3 apply to profits from the participation in a pool, a joint business, or an international operating agency.

ARTICLE 9
Associated Enterprises

This Article complements section 482 of the Code and confirms the right of the United States to allocate items of income, deduction, credit, or allowance in certain cases. Under paragraph 1, if conditions are made or imposed between related enterprises in their commercial or financial relations which differ from those that would be made between independent enterprises, any profits that would, but for those conditions, have accrued to one of the enterprises, but by reason of those conditions have not so accrued, may be included in the profits of that enterprise and taxed accordingly. Enterprises are related for purposes of the Treaty where an enterprise of a Contracting State participates directly or indirectly in the management, control, or capital of an enterprise of the other Contracting State, or the same persons participate directly or indirectly in the management, control, or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State.

Paragraph 2 describes the consequences of an adjustment made by a Contracting State in accordance with paragraph 1. The other Contracting State will make an appropriate adjustment to the amount of tax which it charged to the related enterprise, and in determining the amount of such adjustment, the other provisions of the Treaty shall be taken into account. Thus, if as a

result of the adjustment one enterprise is treated as having made a distribution of profits to the other, the provisions of Article 10 (Dividends) may apply to the deemed distribution. If necessary, the competent authorities are authorized to consult to resolve any differences in the application of these provisions, such as a disagreement over the appropriateness of an adjustment.

Paragraph 3 clarifies that the provisions of paragraph 1 do not limit the application of any internal law provisions in either Contracting State designed to place transactions between related enterprises on an arm's-length basis. Thus, this Article does not limit the right of the United States to apply section 482 of the Code, even when such application may appear to extend beyond the provisions of paragraph 1 of Article 9.

It is understood that the "commensurate with income" standard for determining appropriate transfer prices for intangibles, added to section 482 of the Code by the Tax Reform Act of 1986, was designed to operate in such a way that it does nit represent a departure in U.S. practice or policy from the arm's-length standard. It merely suggests alternative approaches, beyond those spelled out in current regulations, for achieving appropriate transfer prices. It is anticipated, therefore, that the application of this standard by the Internal Revenue Service will be in accordance with the general principles of paragraph 1 and 3 of Article 9 of the Treaty.

ARTICLE 10
Dividends

Under paragraph 1, dividends paid by a company which is a resident of one Contracting State to a shareholder resident in the other Contracting State may be taxed in the State of residence of the recipient.

Such dividends may also be taxed in the State in which the company paying the dividends is resident, but the tax cannot exceed the rates specified in paragraph 2. Paragraph 2(a) provides that the rate of tax shall not exceed 5 percent of the gross amount of the dividends when the beneficial owner is a company which owns at least 10 percent of the voting stock of the company paying the dividends. In all other cases, the tax may not exceed 15 percent of the gross amount of the dividends. These rates are the same as those provided in the 1970 Treaty.

Dividends paid by United States REITs and RICs are subject to special withholding tax limitations. Dividends from RICs are not subject to the 5 percent withholding limitation of paragraph 2(a) but are subject to the 15 percent withholding limitation of paragraph 2(b). It is understood that it would be inappropriate to provide the relief in paragraph 2(a) when the company of which the resident is a 10 percent shareholder is a pass-through entity. Dividends from REITs are subject to the 15 percent withholding limitation, but only if the beneficial owner is an individual holding less than a 10 percent interest in the REIT: in other cases, the Treaty does not provide any reduction on the statutory withholding rate. These rules are provided because conversion of real property income into a dividend by passing it through a REIT controlled by the real property owner should not reduce the tax from that which would be due if the income were derived directly. The appropriate rate on REIT dividends is that rate which

approximates the rate which would apply to net income from real property paid directly to the property owner. As income from real property generally is subject to either a 30 percent withholding rate or a net basis tax, REIT dividends paid to a corporation or individual owning at least 10 percent interest in the REIT are taxed at 30 percent. Some relief from this withholding rate is provided in the case of individuals holding less than 10 percent interest in the REIT. Such individuals are assumed to be taxable at the 15 percent rate on net real property income and, accordingly, are taxed at 15 percent on the REIT dividends.

A resident of a Contracting State may benefit from this Article only if he derives and beneficially owns the dividend paid by a corporation of the other Contracting State. The term "beneficial owner" is not defined in the Treaty; it is, instead, defined by domestic law of the Contracting State. A nominee or agent which is a resident of a Contracting State may not claim the benefits of this Article if the dividend is received on behalf of a person who is not a resident of that Contracting State. However, dividends received by a nominee for the benefit of a resident would qualify for the benefits of this Article.

This Article is subject to the saving clause of paragraph 3 of Article 1 (Personal Scope). Thus, dividends derived by a citizen of a Contracting State may be taxed by that Contracting State without regard to this Article.

Paragraph 3 defines "dividends" as income from shares or other rights participating in profits, but not debt-claims, and income from other corporate rights taxed in the same way as income from shares under the tax law of the Contracting State of which the company making the distribution is a resident. Income from certain arrangements, including debt-claims or debt obligations, which carry the right to participate in profits, may be treated as dividends to the extent so treated under the laws of the State in which the income arises. Income from debt-claims not carrying the right to participate in profits is covered by Article 11 (Interest). Thus, it is understood that each Contracting State will apply its domestic law in differentiating dividends from interest and other distributions or disbursements. Should a conflict arise in this regard, the competent authorities are authorized by Article 25 (Mutual Agreement Procedure) to seek to resolve any such conflict.

Paragraph 4 provides that where the holding in respect of which dividends are paid is effectively connected with a permanent establishment or fixed base of the recipient in the country of which the company paying the dividends is a resident, then the dividends are taxable in accordance with the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, rather than under the provisions of paragraph 2 of this Article.

Paragraph 5 provides, as a general rule, that a Contracting State may not impose tax on dividends paid by a company which is not a resident of that Contracting State. Paragraph 5 goes on to provide two exceptions to this rule:

(1) where the dividends are paid to a resident of the first-mentioned State, or

(2) where the dividends are attributable to a permanent establishment or a fixed base of the beneficial owner in the first State:

For example, if a company which is not a resident of Finland pays dividends, those dividends may be taxed by the United States in two circumstances:

(1) if the dividends are paid to a resident of the United States, or

(2) if the dividends are attributable to (i.e., are part of the income of) a permanent establishment or a fixed base of the beneficial owner of the dividends situated in the United States.

Thus, neither Contracting State may impose a "second" dividend withholding tax of type formerly imposed by the United States under section 861(a)(2) of the Code on dividends paid by a resident of the other Contracting State (except as provided for in paragraph 6 concerning branch tax).

Paragraph 6 explicitly confirms the right of a Contracting State to impose a branch profits tax. Such a branch profits tax imposed on payments or deemed payments from branch to home office can be viewed as analogous to the withholding taxes which would be imposed on the dividends paid by a subsidiary to a parent corporation.

In the case of the United States, under subparagraph (a), the amount of branch profits subject to tax is the portion of the business profits of the Finnish company which is effectively connected (or treated as effectively connected) with its conduct of a trade or business in the United States and which represents the "dividend equivalent amount" as defined in section 884(b) of the Code. That is, the branch tax may be imposed on a portion of the business profits of the Finnish company attributable to its permanent establishment in the United States, as well as a portion of the income subject to a net basis tax under Article 6 (Income from Immovable (Real) Property) or paragraph 1 of Article 13 (Gains).

Paragraph 6, however, does not impose a tax on "excess interest" payments (as defined by section 884(f) of the Code) deemed to be received by a Finnish corporation because interest payments derived and beneficially owned by a Finnish corporation are exempt from U.S. withholding tax pursuant to paragraph 1 of Article 11 (Interest).

Subparagraph (b) of Paragraph 6 provides complementary treatment for Finland with respect to the branch taxes described in subparagraph (a). Although Finland currently does not have statutory provisions for imposition of a branch tax, subparagraph (b) preserves the right for Finland to impose such a tax if it is subsequently enacted.

Paragraph 7 limits the rate of the branch tax imposed pursuant to paragraph 6 to 5%.

ARTICLE 11
Interest

This Article deals with the taxation by one Contracting State of interest derived and beneficially owned by a resident of the other Contracting State.

Paragraph 1 provides that only the Contracting State in which the beneficial owner is

resident may tax the interest. Thus, the exemption does not apply where an intermediary, which is a resident of a Contracting State, such as an agent or nominee, collects or receives the interest on behalf of a person who is not a resident of a Contracting State. The Treaty confirms the exemption at source for interest contained in the 1970 Treaty.

Paragraph 2 contains the definition of interest which is essentially the same as that found in the U.S. Model with two modifications. The first modification is an exclusionary reference to debt-claims carrying a participation in profits which are characterized by the source State as dividends in accordance with paragraph 3 of Article 10 (Dividends). The second modification is a reference to domestic law which expands the usual definition of interest to include any income which is treated as income from money lent by the domestic taxation law in the State in which the income arises. As used in the definition of interest, the phrase "premiums or prizes attaching to such securities, bonds or debentures" is understood to cover the coupon or redemption payments attached to a "lottery bond". In general, for lottery bonds, a portion of the outstanding bonds are chosen by lot each year for redemption. Because of the element of gambling inherent in these bonds, their use generally is illegal in the United States.

Paragraph 3 confirms the understanding that excess interest payments deemed to be received by a Finnish corporation under section 884(f) of the Code are treated as interest derived and beneficially owned by a resident of Finland and, therefore, are exempt from U.S. tax pursuant to paragraph 1 of this Article.

Paragraph 4 provides that the exemption from tax provided by paragraph 1 shall not apply if the debt-claim in respect of which the interest is paid is effectively connected with a permanent establishment or fixed base which the beneficial owner of the interest, a resident of a Contracting State, maintains or maintained in the other Contracting State. In such a case, the interest will be treated as business profits or as income from independent personal services taxable in accordance with the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, rather than under this Article.

If excessive interest is paid pursuant to a special relationship between the payer and the person beneficially owning the interest or between both of them and a third person, paragraph 5 slates that the provisions of Article 11 shall not apply to the excess portion of the payment. The excess portion may be taxed by each Contracting State in accordance with its own law, including the Treaty where applicable. In the case of the United States, the excess portion may, for example, be taxed as a dividend, in which case the provisions of Article 10 (Dividends) will apply.

This Article is subject to the saving clause of paragraph 3 of Article I (Personal Scope), so that, for example, the United States may tax a U.S. citizen on his interest income in all cases, even if he is a resident of Finland.

ARTICLE 12
Royalties

Paragraph 1 provides the general rule that royalties derived and beneficially owned by a resident of a Contracting State shall be taxable only in that State.

Paragraph 2 provides that the exemption at source provided in paragraph 1 will not apply to royalties described in subparagraphs (b) and (c) of paragraph 3. Such royalties may be taxed in the Contracting State in which they arise at a rate not to exceed 5 percent of the gross amount of the royalties, if the beneficial owner of the royalties is a resident of the other Contracting State. This provision reflects a change in Finnish policy; the 1970 Treaty exempted such royalties from tax at source.

Paragraph 3 defines the term "royalties" as payment of any kind received as consideration for the use of, or the right to use, three categories of rights or property. Paragraph 3(a) identifies copyrights of literary, artistic, or scientific works, including motion picture films, films or tapes used for radio or television broadcasting. A copyright of scientific works is understood to include computer software. Royalties of the kind described in subparagraph (a) are exempt from tax at source pursuant to paragraph 1. Paragraph 3(b) identifies any patents, trademark, design or model, plan, secret formula or process or other like right or property. Paragraph (c) identifies as royalties payments for information concerning industrial, commercial, or scientific experience. This term includes "know-how" and similar experience or skill, including the supply of assistance of an ancillary and subsidiary nature furnished as a means of enabling the application or enjoyment of any such right or property.

The term "royalties" also includes gains derived from the alienation (e.g., the sale, exchange, or other disposition) of any such right or property to the extent the amounts realized on such alienation are contingent on the productivity, use, or disposition of the right or property. If the amounts realized are not so contingent, the provisions of Article 13 (Gains) may apply.

Paragraph 4 provides that where the right or property in respect of which royalties are paid is effectively connected with a permanent establishment or fixed base maintained by the beneficial owner of the royalties in the other Contracting State, then the royalties shall be taxed in accordance with the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), rather than in accordance with the provisions of this Article.

Paragraph 5 identifies the State in which royalties are deemed to arise. The general rule is that royalties arise in a Contracting State when the payer is that State itself or a political subdivision, statutory body, local authority, or resident of that State. Since this rule may conflict with the U.S. statutory rule which sources royalties in the State in which property or rights are used, it was deemed necessary to provide an exception to the general rule with respect to the use of property in a Contracting State. Under this exception, payments for the use of or the right to use property or rights in a Contracting State are deemed to arise in the State in which they are used. Thus, if a U.S. resident licensor receives royalties from a resident of Finland for the use of a patent in Finland, the royalty will be deemed to arise in Finland. If, however, the Finnish resident uses the patent in the United States, the royalty will be deemed to arise in the United States. Because of the exception, the United States will not be required to credit a Finnish tax on an item of income which, under U.S. law, would have a U.S. source.

Under paragraph 6, if excessive royalties are paid pursuant to a special relationship between the payer and the beneficial owner of the royalty or between both of them and a third person, the provisions of this Article shall not apply to the excess portion of the payment. The excess portion may be taxed in each Contracting State in accordance with its own law, including the Treaty where applicable. In the case of the United States, the excess portion may, for example, be taxed as a dividend, in which case the provisions of Article 10 (Dividends) will apply.

This Article is subject to the saving clause of paragraph 3 of Article 1 (Personal Scope). Thus, for example, the United States may tax a U.S. citizen who is resident in Finland on any royalty income.

ARTICLE 13
Gains

This Article provides rules for the taxation of certain gains derived by a resident of a Contracting State.

Paragraph 1 of Article 13 states the rule that gains derived by a resident of a Contracting State from the alienation or disposition of immovable (i.e., real) property situated in the other Contracting State may be taxed by that other State.

For purposes of paragraph 1, paragraph 2 defines the term "immovable (real) property situated in the other Contracting State" as property described in paragraph 2 of Article 6 (Income from Immovable (Real) Property) situated in the other Contracting State. In the case of the United States, paragraph 2 also provides that the term includes a United States real property interest. Thus, the United States retains its full taxing right under the Foreign Investment in Real Property Tax Act (section 897 of the Code). In the case of Finland, paragraph 2 provides that the term also includes shares or other corporate rights described in paragraph 4 of Article 6.

Paragraph 3 provides that a Contracting State may tax gains from the alienation or disposition of movable property which is part of the property of a permanent establishment or fixed base in that State maintained by a resident of the other Contracting State.

Paragraphs 1 and 3 do not confer an exclusive right to tax on the State of source. Such gains may also be taxed by the State of residence, subject to the provisions of Article 23 (Elimination of Double Taxation).

Under paragraph 4, gains derived by an enterprise of one Contracting State from the alienation of ships, aircraft, or containers operated in international traffic are taxable only in that Contracting State. Consistent with the definition of containers provided in paragraph 3 of Article 8, for purposes of this paragraph, containers include trailers, barges, and related equipment for the transport of containers.

Paragraph 5 provides that gains described in Article 12 (Royalties) (i.e., gains from the

alienation of a right or property which are contingent on the productivity, use, or disposition thereof) are not taxable in accordance with this Article but, instead, in accordance with the provisions of Article 12.

Paragraph 6 provides that gains from the alienation of any property other than property identified in paragraphs 1, 3, 4 and 5 are taxable only in the Contracting State of which the alienator is a resident.

Though paragraphs 4 and 6 provide an exclusive right to tax in the Contracting State of residence, these provisions are subject to the saving clause of paragraph 3 of Article 1 (Personal Scope). Thus, a resident of Finland who is a citizen of the United States may be subject to United States tax on gains from the alienation of property described in paragraphs 4 and 6 notwithstanding the provisions of those paragraphs.

ARTICLE 14
Independent Personal Services

The Treaty provides separate articles dealing with the taxation of income from independent and dependent personal services. Independent personal services are, in general, services performed by an individual for his own account where he receives the income and bears the losses arising from such services. Income from services in which capital is a material income-producing factor, however, will generally be governed by the provisions of Article 7 (Business Profits). Generally, services rendered, for example, by physicians, lawyers, engineers, architects, dentists, artistes, athletes, and accountants who perform personal services as sole proprietors or partners are independent personal services, whereas services performed as an employee or as an officer of a corporation constitute dependent personal services.

Article 14 provides that income derived by an individual who is a resident of a Contracting State from the performance of personal services in an independent capacity shall generally be taxable only in that State. However, such income may also be taxed in the other Contracting State if the services are performed in that other State and the income is attributable to a fixed base in that other State which the individual has or had regularly available for the purpose of performing his activities. The term "fixed base" is not defined, but should be understood to be analogous to the term "permanent establishment."

This Article is subject to the provisions of the saving clause in paragraph 3 of Article 1 (Personal Scope). Thus, for example, a resident of Finland who is a citizen of the United States may be taxed by the United States on his personal service income notwithstanding the provisions of this Article.

ARTICLE 15
Dependent Personal Services

Paragraphs 1 and 2 of this Article are essentially the same as the corresponding

paragraphs of Article 15 of the U.S. Model. These provide that, subject to the provisions relating to pensions, annuities, alimony and child support (Article 18) and income from government service (Article 19), remuneration derived by a resident of a Contracting State in respect of an employment may be taxed by the other Contracting State only to the extent that the remuneration is for employment exercised in that other Contracting State. Even in that event, the remuneration is taxable only in the Contracting State of residence of the recipient if he is present in the other Contracting State for not more than 183 days in the taxable year, he is paid by or on behalf of an employer who is not a resident of the other Contracting State, and the remuneration is not borne as a deduction by a permanent establishment or fixed base of the employer in the other Contracting State.

Paragraph 3 provides a special rule for members of the regular complement of ships or aircraft operated in international traffic by a resident of a Contracting State. Remuneration for such services is taxable in the Contracting State of residence of the operator. This paragraph does not grant an exclusive taxing right. This paragraph differs, at the request of Finland, from the rule in the U.S. Model which provides for the exclusive right to tax such income in the State of residence of the employee.

This Article is subject to the saving clause of paragraph 3 of Article 1 (Personal Scope). A citizen of the United States who is a resident of Finland may, therefore, be taxed by the United States on his employment income without regard to the limitations of this Article.

ARTICLE 16
Limitation on Benefits

Article 16 assures that source basis tax benefits granted by a Contracting State pursuant to the Treaty are limited to the intended beneficiaries - residents of the other Contracting State - and are not extended to residents of third States not having a substantial business in, or business nexus with, the other Contracting State. For example, a resident of a third State might establish an entity resident in one of the Contracting States for the purpose of deriving income from the other Contracting State and claiming source State benefits with respect to that income. Absent Article 16, the entity would generally be entitled to benefits as a resident of a Contracting State, subject, however, to such limitations (e.g., business purpose, substance-over-form, step transaction or conduit treatment) as may be applicable to the transaction or arrangement under the domestic law of the source State.

The structure of the Article is as follows: Paragraph 1 lists a series of attributes of a resident of a Contracting State, the presence of any one of which will entitle that person to benefits of the Treaty in the other Contracting State. Several of these, which will be discussed later, are purely objective tests. One, in subparagraph (c), is more subjective and requires some elaboration and interpretation. Paragraph 2 provides that benefits may be granted even to a person not entitled to benefits under the tests of paragraph 1, if the competent authority of the source State so determines. Paragraph 3 defines the term "recognized stock exchange" as used in paragraph 1.

Two categories of persons eligible for benefits from the other Contracting State under subparagraphs (a) and (b) of paragraph 1 are

(1) individual residents of a Contracting State and

(2) the Contracting States, political subdivisions or local authorities thereof.

It is most unlikely that persons falling into these two categories can be used to derive Treaty-benefited income on behalf of a third-country person. If an individual is receiving income as a nominee on behalf of a third country resident, benefits will be denied with respect to those items of income under the articles of the Treaty which grant the benefit, because of the requirements in those articles that the beneficial owner of the income be a resident of a Contracting State.

Subparagraph l(c) of Article 16 provides a test for eligibility for benefits which looks not solely at objective characteristics of the person deriving the income, but at the nature of the activity engaged in by that person and the connection between the income and that activity. Under the subparagraph, a resident of a Contracting State deriving income from the other Contracting State is entitled to benefits if the person is engaged in an active trade or business in his State of residence, and the item of income in question is derived in connection with, or is incidental to, that trade or business. Income which is derived in connection with, or is incidental to, the business of making or managing investments will not qualify for benefits under this provision, unless the business is a bank or insurance company engaged in banking or insurance activities.

In general, it is expected that if a person qualifies for benefits under the other subparagraphs of paragraph 1, no inquiry will be made into qualification for benefits under subparagraph l(c). Upon satisfaction of any of the other tests of paragraph 1, any income derived by the beneficial owner from the other Contracting State is entitled to Treaty benefits. Under subparagraph l(c), however, the test is applied separately for each item of income.

It is intended that the provisions of subparagraph l(c) will be self-executing. Unlike the provisions of paragraph 2, discussed below, claiming benefits under this subparagraph does not require advance competent authority ruling or approval. The tax authorities may, of course, on review, determine that the taxpayer has improperly interpreted the subparagraph and is not entitled to the benefits claimed.

An informal memorandum of understanding was exchanged at the time of the negotiation of the Treaty which suggests, by means of examples, the understandings reached by the negotiators as to the intended scope of subparagraph 1(c). The examples, structured for purposes of exposition in terms of a Finnish entity claiming U.S. Treaty benefits, are reproduced in the following paragraphs. They are not intended to be exhaustive, but are merely illustrative of the kinds of considerations which are relevant in making a determination as to whether a particular case falls within the scope of subparagraph l(c). It is anticipated that as the competent authorities and taxpayers gain more experience with the concepts in this Article, some of which are relatively new, further guidance will be developed and made public.

Example I

Facts: A Finnish resident company is owned by three persons, each resident in a different third country. The company is engaged in an active manufacturing business in Finland. It has a wholly-owned subsidiary in the United States which has been capitalized with debt and equity. The subsidiary is engaged in selling the output of the Finnish parent. The active manufacturing business in Finland is substantial in relation to the activities of the U.S. subsidiary. Are the subsidiary's interest and dividend payments to its Finnish parent eligible for Treaty benefits in the United States?

Analysis: Treaty benefits would be allowed because all of the conditions of paragraph l(c) are met. First, the Finnish resident is "engaged in the active conduct of a trade or business" in Finland because that trade or business has substance (i.e., it is substantial in relation to the business of the U.S. subsidiary). Second, the income which the Finnish company derives from the United States is derived in connection with the Finnish business. In this case the connection is in the form of a "downstream" connection, *i.e.*, the income payments flowing from the U.S. subsidiary to the Finnish parent are generated by the U.S. subsidiary's sales of the products manufactured by the Finnish parent.

Example II

Facts: The facts are the same as in Example I except that while the income is derived by the Finnish parent of the U.S. subsidiary, the relevant business activity in Finland is carried on by a Finnish subsidiary company. The Finnish subsidiary's activities meet the business relationship and substantiality tests of the business connection provision as described in the preceding example. Are the U.S. subsidiary's dividends and interest payments to the Finnish parent eligible for U.S. Treaty benefits?

Analysis: Benefits are allowed because the two Finnish entities (i.e., the one deriving the income and the one carrying on the substantial active business in Finland) are related. Benefits are not denied merely because the income is earned by a Finland holding company and the relevant activity is carried on in Finland by a Finnish subsidiary. The existence of a similar holding company structure in the United States would not affect the right of the Finnish parent to Treaty benefits. Thus, if the Finnish parent owns a subsidiary in the United States which is, itself, a holding company for the group's U.S. activities, which are related to the business activity in Finland, dividends paid by the U.S. holding company to the Finnish parent holding company would be tested for eligibility for benefits in the same way as described above, ignoring the fact that the activities are carried on by one entity and the income in respect of which benefits are claimed is paid by another, related, entity.

Example III

Facts: A Finnish resident company is owned by three persons, each resident in a different third country. The company is the worldwide headquarters and parent of an integrated international business carried on through subsidiaries in many countries. The company's wholly-owned U.S. and Finnish subsidiaries manufacture, in their countries of residence, products which are part of the group's product line. The United States subsidiary has been capitalized with debt and equity. The active manufacturing business of the Finnish subsidiary is substantial in relation to the activities of the U.S. subsidiary. The Finnish parent manages the worldwide group and also performs research and development to improve the manufacture of the group's product line. Are the U.S. subsidiary's dividend and interest payments to its Finnish parent eligible for Treaty benefits in the United States?

Analysis: Treaty benefits would be allowed because the Treaty requirement that the United States income "is derived in connection with or is incidental to" the Finnish active business is satisfied. This conclusion is based on two elements in the fact pattern presented:

(1) the income is connected with the Finnish active business because the United States subsidiary and the Finnish subsidiary manufacture products which are part of the group's product line, the Finnish parent manages the worldwide group, and the parent performs research and development that benefits both subsidiaries; and

(2) the active Finnish business is substantial in relation to the business of the U.S. subsidiary.

Example IV

Facts: A third-country resident establishes a Finnish company for the purpose of acquiring a large U.S. manufacturing company. The sole business activity of the Finnish company (other than holding the stock of the U.S. company) is the operation of a small retailing outlet which sells products manufactured by the U.S. company. Is the Finnish company entitled to Treaty benefits under paragraph 1(c) with respect to dividends it receives from the U.S. manufacturer?

Analysis: The dividends would not be entitled to benefits. Although there is, arguably, a business connection between the U.S. and the Finnish businesses, the "substantiality" test described in the preceding examples is not met.

Example V

Facts: Finnish, Swedish and Danish companies create a joint venture in the form of a partnership organized in Finland to manufacture a product in a developing country. The joint venture owns a U.S. sales company, which pays dividends to the joint venture. Are these dividends eligible for benefits of the Treaty?

Analysis: Under Article 4, only the Finnish partner is a resident of Finland for purposes of the Convention. The question arises under this Convention, therefore, only with respect to the Finnish partner's share of the dividends. If the Finnish partner meets

the ownership and base erosion tests or the public trading test of paragraph 1(d) or (e), it is entitled to benefits without reference to paragraph 1(c). If not, the analysis 6f the previous examples would be applied to determine eligibility for benefits under paragraph 1(c). The determination of Treaty benefits available to the Swedish and Danish partners will be made under the United States conventions with Sweden and Denmark.

Example VI

Facts: A Finnish company, a Swedish company and a Danish company create a joint venture in the form of a Finnish resident company in which they take equal shareholdings. The joint venture company engages in an active manufacturing business in Finland. Income derived from that business that is retained as working capital is invested in U.S. Government securities and other U.S. debt instruments until needed for use in the business. is interest paid on these instruments eligible for benefits of the Treaty?

Analysis: The interest would be eligible for Treaty benefits. Interest income earned from short-term investment of working capital is incidental to the business in Finland of the Finnish joint venture company.

Subparagraph (d) of paragraph 1 of this Article 16 provides a two-part test, the so-called ownership and base erosion tests, both of which must be met for entitlement to benefits under this subparagraph. Under these tests, benefits will be granted to a resident of a Contracting State other than an individual, such as a corporation, partnership or trust, if both

(1) more than 50 percent of the beneficial interest in the person (or, in the case of a corporation, more than 50 percent of each class of its shares) is owned, directly or indirectly, by persons who are themselves entitled to benefits under the other tests of paragraph 1, or by U.S. citizens, and

(2) not more than 50 percent of the person's gross income is used, directly or indirectly, to make deductible payments to persons, other than persons who are themselves eligible for benefits under the other tests of paragraph 1, or to U.S. citizens.

It is understood that the term "gross income" is to be interpreted as in U.S. law. Thus, in general, the term should be understood to mean gross receipts less cost of goods sold.

The rationale for this two-part test is that since Treaty benefits can be indirectly enjoyed not only by equity holders of an entity, but also by that entity's various classes of obligees, such as lenders, licensors, service providers, insurers and reinsurers, and others, it is not enough, in order to prevent such benefits from inuring substantially to third-country residents, merely to require substantial ownership of the entity by Treaty country residents or their equivalents. It is also necessary to require that the entity's deductible payments be made in substantial part to such Treaty country residents or their equivalents. For example, a third-country resident could lend funds to a Finnish-owned corporation to be reloaned to the United States. The U.S. source interest income of the Finnish corporation would be exempt from U.S. withholding tax under Article 11 (Interest) of the Treaty. While the Finnish corporation would be subject to Finnish

corporation income tax, its taxable income could be reduced to near zero by the deductible interest paid to the third-country resident. If, under a Treaty between Finland and the third country, that interest is exempt from Finnish tax, the U.S. Treaty benefit with respect to the U.S. source interest income will have flowed to the third country resident.

Under subparagraph (e), a corporation which is a resident of a Contracting State is entitled to Treaty benefits from the other Contracting State if there is substantial and regular trading in the corporation's principal class of shares on a recognized stock exchange. The term "recognized stock exchange" is defined in paragraph 3 of the Article to mean, in the United States, the NASDAQ System and any stock exchange which is registered as a national securities exchange with the Securities and Exchange Commission, and, in Finland the Helsinki Stock Exchange. Paragraph 3 also provides that the competent authorities may, by mutual agreement, recognize additional exchanges for purposes of subparagraph 1(e).

Subparagraph (f) provides that a not-for-profit organization which is a resident of a Contracting State is entitled to benefits from the other Contracting State if it satisfies two conditions

(1) it must be generally exempt from tax in its State of residence by virtue of its not-for-profit status, and

(2) more than half of the beneficiaries, members or participants if any in the organization must be persons entitled, under this Article, to the benefits of the Treaty.

The not-for-profit organizations dealt within subparagraph 1(f) include pension funds, pension trusts, private foundations, trade unions, trade associations and similar organizations.

Paragraph 2 of Article 16 provides that a resident of a Contracting State that derives income from the other Contracting State and is not entitled to the benefits of the Treaty under any of the provisions of paragraph 1 may, nevertheless, be granted benefits at the discretion of the competent authority of the Contracting State in which the income arises.

The paragraph itself provides no guidance to competent authorities or taxpayers as to how the discretionary authority is to be executed. As in the case of paragraph 1(c), an informal memorandum of understanding was developed by the negotiators to provide guidance. Relevant portions of that memorandum are reproduced in the discussion that follows.

It is assumed that, for purposes of implementing paragraph 2, taxpayers will be permitted to present their cases to the competent authority for an advance determination based on the facts, and will not be required to wait until the tax authorities of one of the Contracting States have determined that benefits are denied. In these circumstances, it is also expected that if the competent authority determines that benefits are to be allowed, they will be allowed retroactively to the time of entry into force of the relevant Treaty provision or the establishment of the structure in question, whichever is later.

In making determinations under paragraph 2, it is understood that the competent authorities will take into account all relevant facts and circumstances. The factual criteria which the competent authorities are expected to take into account include the existence of a clear business purpose for the structure and location of the income earning entity in question; the

conduct of an active trade or business (as opposed to a mere investment activity) by such entity; and a valid business nexus between that entity and the activity giving rise to the income. The competent authorities will also consider, for example, whether and to what extent a substantial headquarters operation conducted in a Contracting State by employees of a resident of that State contributes to such valid business nexus, and should not, therefore, be treated merely as the "making or managing [of] investments" within tile meaning of paragraph 1(c) of Article 16.

The discretionary authority granted to the competent authorities in paragraph 2 is particularly important in view of the developments in, and objectives of, international economic integration; such as that between the member countries of the European countries and between the United States and Canada.

The following example illustrates the application of these principles.

Example VII

Facts: Finnish, Swedish and Danish companies, each of which is engaged directly or through its affiliates in substantial active business operations in its country of residence, decide to cooperate in the development, production, and marketing of an advanced passenger aircraft through a corporate joint venture with its statutory seat in Finland. The development, production and marketing aspects of the project are carried out by the individual joint venturers. The joint venture company, which is staffed with a significant number of managerial and financial personnel seconded by the joint venturers, acts as the general headquarters for the joint venture, responsible for the overall management of the project including coordination of the functions separately performed by the individual joint venturers on behalf of the joint venture company, the investment of working capital contributed by the joint venturers and the financing of the project's additional capital requirements through public and private borrowings. The joint venture company derives portfolio investment income from U.S. sources. Is this income eligible for benefits of the Treaty?

Analysis: If the joint venture company's activities constitute an active business and the income is connected to that business, benefits would be allowed under paragraph 1(c). If not, it is expected that the U.S. competent authority would determine that Treaty benefits should be allowed in accordance with paragraph (2) under tile facts presented, particularly in view of:

(1) the clear business purpose for the formation and location of the joint venture company;

(2) the significant headquarters functions performed by that company in addition to financial functions; and

(3) the fact that all of the joint venturers are companies resident in Nordic countries in which they are engaged directly or through their affiliates in substantial active business operations.

The competent authorities will consult further on these issues."

In applying this Article 16 the normal burden of proof rules apply. For example, under present U.S. procedures, an entity that is a resident of Finland and that believes it is entitled, under one of the alternative tests of this Article, to the exemption from U.S. tax on interest provided by Article 11 (Interest) would merely file a U.S. Form 1001 with the appropriate withholding agent to claim the benefit. Of course, the Internal Revenue Service could, on audit, examine the transaction.

ARTICLE 17
Artistes and Sportsmen

This Article deals with the taxation of income derived by entertainers, musicians, athletes, and other sportsmen (sometimes referred to hereinafter as "artistes and sportsmen") from the performance of services. Throughout this Article, at the request of Finland, the term "sportsmen" is used in place of the term "athletes" used in the U.S. Model. This change clarifies that income derived by a sportsman, such as an athlete or a chess player, is covered by this Article, but no difference in meaning is intended.

The Article applies in cases where an artiste or sportsman performs services on his own behalf and in cases where services are performed on behalf of another person, as an employee or pursuant to any other arrangement.

Paragraph 1 states the general rule that, notwithstanding the provisions of Article 14 (Independent Personal Services) and Article 15 (Dependent Personal Services), income derived by entertainers (such as theatre, motion picture, radio, or television artistes), musicians, and sportsmen, from their personal activities as such, may be taxed in the Contracting State where those services are exercised except where the amount of gross receipts of an artiste or sportsman for such services, including expenses reimbursed or paid on his behalf, does not exceed $20,000 (or the equivalent in Finnish currency) for the taxable year. In the event the $20,000 threshold is exceeded, the full amount may be taxed by the Contracting State in which the services are exercised. If this Article does not permit taxation at source, the income may nevertheless be taxed in the source State if it is taxable under Article 14 (Independent Personal Services) or Article 15 (Dependent Personal Services).

Income derived from services rendered by producers, directors, technicians, and others who are not artistes or sportsmen is taxable in accordance with the provisions of Article 14 (Independent Personal Services). or Article 15 (Dependent Personal Services), as the case may be.

Paragraph 2 deals with cases in which income in respect of the activities of an entertainer or sportsman accrues to a person other than, or in addition to, the entertainer or sportsman. Foreign entertainers commonly perform services in the United States as employees of, or contractors for, a company or other person. That person may act as the nominal recipient of the income in respect of the entertainer's services, and the entertainer may act as its "employee" or

"contractor." In such cases, the company may escape taxation in respect of those services under the provisions of Article 7 (Business Profits) because it does not have a permanent establishment in the United States. The entertainer may also escape taxation by taking a small salary while in the United States and then either receiving payment in a later year when the income is subject to little or no tax, or liquidating the company after the services are performed.

Paragraph 2 provides that income in respect of the personal activities of an artiste or sportsman which accrues to the benefit of another person (including a company, trust, or partnership of either Contracting State or any third State) may, notwithstanding the provisions of Articles 7 (Business Profits) and 14 (Independent Personal Services), be taxed by the Contracting State in which the activities of the entertainer or sportsman take place, unless it is established that there was no participation by the entertainer or sportsman or any related persons, directly or indirectly, in any profits of such other person in any manner. Such profit participation may be in various forms including the receipt of deferred compensation, bonuses, fees, dividends, partnership distributions, or other distributions. Depending on the facts in a particular case, a person may be considered to be related to an artiste or sportsman if he is an employee or agent of the artiste or sportsman or if he is regularly employed by the artiste or sportsman in an advisory capacity, such as his attorney, accountant, or investment advisor. Paragraph 2 does not affect the rule of paragraph 1 that applies to the artiste or sportsman himself.

This Article is subject to the saving clause in paragraph 3 of Article 1 (Personal Scope). Thus, an artiste or sportsman who is a resident of Finland and a citizen of the United States would, notwithstanding this Article, be fully subject to U.S. tax.

ARTICLE 18
Pensions, Annuities, Alimony, and Child Support

This Article is essentially the same as Article 18 of the U.S. Model. Paragraph 1 provides that, subject to the provisions of Article 19 (Government Services), pensions and similar remuneration derived and beneficially owned by a resident of one Contracting State in consideration of past employment are taxable only in the State of residence. Paragraph 1 also provides that social security payments and, in the case of the United States, other public pensions, paid by one of the Contracting States to a resident of the other Contracting State or to a United States citizen are taxable only in the paying State. Such payments include social security payments and U.S. railroad retirement benefits. The reference to U.S. citizens is to ensure that a social security payment by Finland to a U.S. citizen not resident in the United States will not be taxable by the United States. The reference to Article 19 places the treatment of pensions for government service under the rules of that Article rather than this one.

Paragraph 2 provides that annuities derived and beneficially owned by a resident of a Contracting State are taxable only in that Contracting State.

Paragraph 3 provides that alimony paid to a resident of a Contracting State will be taxable only in that Contracting State. The term "alimony" is defined as periodic payments made pursuant to a written separation agreement or a decree of divorce, separate maintenance, or

compulsory support which are taxable to the recipient under the internal laws of the Contracting State of which he is a resident. Thus, the term "alimony" would not include a payment which would not be taxable to the recipient under the laws of the Contracting State in which he is a resident even though such payment is made pursuant to a decree of divorce or of separate maintenance. The explicit reference to a decree of compulsory support is consistent with section 71 of the Code.

Paragraph 4 provides that child support payments made by a resident of one Contracting State to a resident of the other Contracting State are taxable only in the country of residence of the payor. The term "child support payments" is defined as periodic payments for the support of a minor child made pursuant to a written separation agreement or a decree of divorce, separate maintenance, or compulsory support.

Paragraphs 1(b) and 4 of this Article are exceptions to the saving clause of paragraph 3 of Article 1 (Personal Scope). Thus, a U.S. resident or a U.S. citizen, wherever resident, who receives a Finnish social security or child support payment will be exempt from U.S. tax under this Article. Paragraphs l(a), 2 and 3 of this Article are subject to the saving clause. Therefore, a U.S. citizen who is a resident of Finland and who, for example, receives a U.S. private pension or annuity may be taxed by the United States on those payments notwithstanding the exclusive taxing right given to Finland under this Article.

ARTICLE 19
Government Service

Paragraph 1 provides that, as a general rule, remuneration (other than pensions) paid by a Contracting State or a political subdivision, statutory body or local authority thereof to any individual for services rendered to that State, subdivision, body or authority shall be taxable only in that Contracting State. It also provides an exception, however, under which such remuneration shall be taxable only in the other Contracting State if the services are rendered in that other Contracting State by an individual who is a resident of that other Contracting State and who either is also a national of that Contracting State or did not become a resident of that State solely for the purpose of performing the services (for example, if the individual was already a local resident when hired by the first Contracting State).

Paragraph 2 provides that a pension paid by a Contracting State or a political subdivision, statutory body or a local authority thereof to any individual as consideration for services rendered to that Contracting State or subdivision or local authority is taxable only in that Contracting State unless the recipient is both a national and a resident of the other State. In the latter case, such income is taxable only in the other Contracting State.

Under paragraph 3, the provisions of this Article apply only to remuneration and pensions in respect of services of a governmental nature. Remuneration and pensions in respect of services performed in connection with a business carried on by a Contracting State or a political subdivision, statutory body or local authority thereof are taxable under the provisions of Articles 14 (Independent Personal Services), 15 (Dependent Personal Services), or 18 (Pensions,

Annuities, Alimony, and Child Support). Whether functions are of a governmental nature may be determined by reference to the concept of a governmental function in the Contracting State in which the income arises.

Pursuant to paragraph 4(b) of Article 1 (Personal Scope), the benefits of this Article conferred by a Contracting State are not subject to the saving clause of paragraph 3 of Article I, with respect to individuals who are neither citizens of, nor lawful permanent residents in, that State. Thus, for example, an individual who is a U.S. citizen or a lawful permanent resident of the United States would, notwithstanding this Article, be fully subject to U.S. tax.

ARTICLE 20
Students and Trainees

This Article is the same as Article 20 of the U.S. Model. It provides that a resident of one of the Contracting States who goes to the other Contracting State for the purpose of full-time education or training shall be exempt from tax in that other Contracting State on payments made to him which arise outside that Contracting State for the purpose of his maintenance, education, or training.

The benefits conferred by the host State under this Article are not subject to the saving clause of paragraph 3 of Article 1 (General Scope), with respect to individuals who are neither citizens of nor lawful permanent residents in that State. Thus, a citizen of the United States who is a resident of Finland and is in the United States to study at an American university does not benefit from the U.S. exemption accorded by this Article. However, if the individual is not a citizen of the United States, the fact that he may acquire residence (but not immigrant status) in the United States for tax purposes does not deny him the benefits of the Article.

ARTICLE 21
Other Income

This Article is basically the same as Article 21 of the U.S. Model. Paragraph 1 provides the general rule that any income of a resident of a Contracting State which is not covered by other articles of the Treaty shall be taxable only in the State of residence.

The scope of this Article is not confined to income having a source in the other Contracting State but extends, as well, to income from sources in third countries. Moreover, the rule applies irrespective of whether the Contracting State of residence exercises its right to tax the income covered by the Article.

This Article is subject to the saving clause in paragraph 3 of Article 1 (Personal Scope), so that, for example, a resident of Finland who is a citizen of the United States may, notwithstanding the grant of exclusive taxing right to the State of residence, be taxed in the United States on income dealt within this Article.

Paragraph 2 excepts from the rule of paragraph 1 income beneficially owned by a resident of a Contracting State which is effectively connected with a permanent establishment or fixed base of that resident in the other Contracting State. In such cases, the income is covered instead under the provisions of the articles dealing with business profits (Article 7), or independent personal services (Article 14). An exception to the rule established in paragraph 2 is provided for income from immovable property, as defined in paragraph 2 of Article 6 (Income from Immovable (Real) Property). Thus, if a U.S. resident has a permanent establishment in Finland, income from U.S. or third country sources which is attributable to the permanent establishment (other than real property income) would be subject to tax in Finland. Income from real property situated in the United States or a third country, on the other hand, would not be subject to tax in Finland.

ARTICLE 22
Capital

This Article sets forth rules for the taxation of various items of capital. Since there are no United States capital taxes covered by the Treaty, the Article applies only with respect to Finnish taxation. (See, however, the discussion in connection with Article 2 (Taxes Covered) of paragraph 2 of the Exchange of Notes dealing with taxation of capital.)

Paragraphs 1 and 2 deal with capital represented by real property referred to n Article 6 (Income from Immovable (Real) Property). Under paragraph 1, property referred to in paragraph 2 of Article 6 which is owned by a resident of a Contracting State and situated in the other Contracting State may be taxed in the State in which the property is situated. Under paragraph 2, if a resident of a Contracting State owns property referred to in paragraph 4 of Article 6, such property may be taxed in the Contracting State in which is situated the immovable property to which the shares or other corporate rights referred to in paragraph 4 relate.

Paragraph 3 provides that capital represented by assets which are effectively connected with a permanent establishment or fixed base of a resident of a Contracting State, other than capital dealt with in paragraphs 1, 2 and 4 of this Article, may be taxed in the Contracting State in which the permanent establishment or fixed base is situated.

Paragraphs 1, 2 and 3 do not confer an exclusive taxing right.

Under paragraph 4, where a resident of a Contracting State owns ships and aircraft, and other property pertaining to ships and aircraft (other than those items of real property referred to in paragraphs 1 and 2), only the State of residence of the owner of the property may tax that property.

Paragraph 5 provides that all items of capital of a resident of a Contracting State which are not dealt within the preceding paragraphs of this Article may be taxed only by the State of residence of the owner of the capital.

ARTICLE 23
Elimination of Double Taxation

This Article describes the manner in which each Contracting State undertakes to relieve double taxation.

Paragraph 1 of this Article provides the rules for the elimination of double taxation in Finland. The paragraph provides for the relief in Finland of double taxation both with respect to U.S. income and capital taxes. Since there are no U.S. capital taxes covered by the Treaty, the provisions relating to capital taxes are not applicable. This explanation, therefore, will deal only with Finnish relief for income taxes.

Paragraph 1(a) provides that, except to the extent paragraph 1(b) provides a different rule, Finland will allow to a resident of Finland who derives income which may be taxed in the United States in accordance with the Treaty (unless the U.S. right to tax is solely by virtue of citizenship pursuant to the saving clause of paragraph 3 of Article 1 (Personal Scope)), a deduction from Finnish tax. (i.e., a credit) in an amount equal to the tax paid on that income in the United States. The credit, however, may not exceed that part of the Finnish income tax (computed before the credit) which is attributable to the income which may be taxed in the United States.

Paragraph 1(b) provides a special rule for Finnish relief from double taxation in the case of intercorporate dividends, which is an exception to the general rule of paragraph 1(a). Under this subparagraph, dividends received from a company which is a resident of the United States by a company which is a resident of Finland and owns directly at least 10 percent of the voting stock of the company paying the dividends are exempt from Finnish tax.

Paragraph 1(c) provides that, regardless of any other provision of the Treaty, Finland may tax an individual Finnish national who is a resident of the United States, and who, under Finnish taxation laws, is also a resident of Finland. This rule applies even if, under Article 4 (Resident), that individual is treated as being a resident solely of the United States. However, Finland is obligated to allow a credit for any U.S. tax paid on income taxed under this provision, in accordance with the provisions of subparagraph (a) of this paragraph.

Under subparagraph 1(d), where, in accordance with the provisions of the Treaty, Finland exempts an item of income of a resident of Finland, Finland may take the exempted amount of income into account in calculating the amount of tax due on the remaining income of the resident (i.e., Finland may apply exemption with progression).

In paragraph 2(a), the United States agrees to allow to its citizens and residents a credit against U.S. tax for income taxes paid or accrued to Finland. The credit under the Treaty is allowed in accordance with the provisions and subject to the limitations of U.S. law, as that law may be amended over time, so long as the general principle of this Article, i.e., the allowance of a credit, is retained. Thus, although the Treaty provides for a foreign tax credit, the terms of the credit are determined by the provisions, at the time a credit is given, of the U.S. statutory credit.

Paragraph 2(b) also provides for a deemed-paid credit, consistent with sections 902 and 960 of the Code, to a U.S. corporation in respect of dividends received from a Finnish corporation in which the U.S. corporation owns at least 10 percent of the voting shares. This credit is for the tax paid by the Finnish corporation on the earnings out of which the dividends are considered paid.

The taxes referred to in paragraphs l(a) and 2 of Article 2 (Taxes Covered) are considered income taxes for purposes of the credit. This provision, however, is subject to the limitations of U.S. law, as discussed above. Therefore, such taxes will not be considered income taxes for purposes of the credit, if they are not income taxes under U.S. tax law. Capital tax is not considered income tax under U.S. tax law. Therefore, although paragraph l(a) of Article 2 (Taxes Covered) includes capital tax, it will not be considered income tax for foreign tax credit purposes. Nor would it be allowed as a credit against U.S. income tax.

Paragraph 3 provides a special rule for avoiding double taxation of a U.S. citizen who is a resident of Finland. Both the United States and Finland tax the worldwide income of such a person. The special rule provides that, in such a case, Finland will credit the amount of tax which the United States is authorized under the Treaty to impose at source on residents of Finland who are not U.S. citizens. The United States will then credit against any additional U.S. tax the Finland tax net of Finland's foreign tax credit. This paragraph provides that, for purposes of the foreign tax credit limitation, the United States will recharacterize as Finland source income enough U.S. source income to allow the special credit to be utilized. In so doing, the United States will not reduce its tax below the tax it may impose under the Treaty on residents of Finland who are not U.S. citizens.

Paragraph 4 sets forth the source of income rules applicable for purposes of allowing relief under this Article. In general, for U.S. purposes, where source rules are provided in the Treaty for purposes of determining the taxing rights of the Contracting States, these are consistent with the Code source rules for foreign tax credit and other purposes. Where, however, there is an inconsistency between Treaty and Code source rules, the Code source rules (e.g., section 904(g) of the Code) will be used to determine the limits for the allowance of a credit under the Treaty. Similarly, Finland may use any statutory source rules which differ from those provided in the Treaty.

The saving clause in paragraph 3 of Article 1 (Personal Scope) does not apply to this Article. Thus, the provisions of this Article may be relied upon by a citizen or resident of a Contracting State.

ARTICLE 24
Non-Discrimination

This Article assures that nationals of a Contracting State, in the case of paragraph 1, and residents of a Contracting State, in the case of paragraphs 2 through 4, will not be subject to discriminatory taxation in the other Contracting State. For this purpose, nondiscrimination means providing national treatment.

Paragraph 1 provides that a national of one Contracting State may not be subject to taxation or connected requirements in the other Contracting State which are different from, or more burdensome than, the taxes and connected requirements imposed upon a national of that other State in the same circumstances. A national of a Contracting State is afforded protection under this paragraph even if the national is not a resident of either Contracting State. Thus, a U.S. citizen who is resident in a third country is entitled, under this paragraph, to the same treatment in Finland as a Finnish national who is in similar circumstances. The term "national" is defined for each Contracting State in subparagraph 1(f) of Article 3 (General Definitions).

However, the United States is not obligated, by virtue of paragraph 1 of the Article, to apply the same taxing regime to a Finnish national who is not resident in the United States and a U.S. national who is not resident in the United States. The reason for this is that paragraph 1 of the Article applies only when the nationals of the two Contracting States are in the same circumstances. United States citizens who are not residents of the United States but who are, nevertheless, subject to United States tax on their worldwide income are not in the same circumstances with respect to United States taxation as citizens of Finland who are not United States residents. Thus, for example, Article 24 would not entitle a Finnish national not resident in the United States to the net basis taxation of U.S. source dividends or other investment income which applies to a U.S. citizen not resident in the United States.

Paragraph 2 of the Article provides that a permanent establishment in a Contracting State of an enterprise of the other Contracting State may not be less favorably taxed in that other Contracting State than an enterprise of the first-mentioned Contracting State which is carrying on the same activities. This provision, however, does not obligate a Contracting State to grant to a resident of the other Contracting State any tax allowances, reliefs, etc., which it grants to its own residents on account of their civil status or family responsibilities. Thus, if an individual resident in Finland owns a Finnish enterprise which has a permanent establishment in the United States, in assessing income tax on the profits attributable to the permanent establishment, the United States is not obligated to allow to the Finnish resident the personal exemptions for himself and his family which would be allowed if the permanent establishment were a sole proprietorship owned and operated by a U.S. resident.

Section 1446 of the Cede imposes on any partnership with income which is effectively connected with a U.S. trade or business the obligation to withhold tax on amounts allocable to a foreign partner. In the context of the Treaty, this obligation applies with respect to a Finnish resident partner's share of the partnership income attributable to a U.S. permanent establishment. There is no similar obligation with respect to the distributive shares of U.S. resident partners. It is understood, however, that this distinction is not a form of discrimination within the meaning of paragraph 2 of the Article. In distinguishing between U.S. and Finnish partners, the requirement to withhold on the Finnish but not the U.S. partner's share is not discriminatory taxation, but, like other withholding on nonresident aliens, is merely a reasonable method for the collection of tax from persons who are not continually present in the United States, and as to whom it may otherwise be difficult for the United States to enforce its tax jurisdiction. If tax has been over-withheld, the partner can, as in other cases of over-withholding, file for a refund. The relationship between paragraph 2 and the imposition of the branch tax is dealt with below in the

discussion of paragraph 5.)

In addition, paragraph 2 provides that neither country need grant to a company that is resident of the other country the same tax relief that it provides to a company that is a resident of the taxing country with respect to dividends received. Thus, the United States would not have to allow the dividends received deduction to Finnish corporations. Even absent such a specific Treaty provision, the United States contends that Treaty nondiscrimination provisions do not require extension of the dividends received deduction to foreign corporations.

Paragraph 3 prohibits discrimination in the allowance of deductions. When an enterprise of a Contracting State pays interest, royalties or other disbursements to a resident of the other Contracting State, the first-mentioned Contracting State must allow a deduction for those payments in computing the taxable profits of the enterprise under the same conditions as if the payment had been made to a resident of the first-mentioned Contracting State. An exception to this rule is provided for cases where the provisions of paragraph 1 of Article 9 (Associated Enterprises), paragraph 5 of Article 11 (Interest) or paragraph 6 of Article 12 (Royalties) apply, because all of these provisions permit the denial of deductions in certain circumstances in respect of transactions between related persons. The term "other disbursements" is understood to include a reasonable allocation of executive and general administrative expenses, research and development expenses and other expenses incurred for the benefit of a group of related persons which includes the person incurring the expense.

Paragraph 3 also provides that any debts of an enterprise of a Contracting State to a resident of the other Contracting State are deductible in the first-mentioned Contracting State for computing the capital tax of the enterprise under the same conditions as if the debt had been contracted to a resident of the first-mentioned Contracting State. Even though, for most purposes, the Treaty covers only Finnish, and not U.S., capital taxes, under paragraph 6 of this Article, the nondiscrimination provisions apply to all taxes levied in the United States and Finland, at all levels of government. Thus, this provision may be relevant for U.S. as well as Finnish tax purposes, because of taxes on capital, such as real property taxes, levied by state and local governments in the United States.

Paragraph 4 requires that a Contracting State not impose other or more burdensome taxation or connected requirements on an enterprise of that State which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, than the taxation or connected requirements which it imposes on other similar enterprise of that first-mentioned Contracting State.

The Tax Reform Act of 1986 ("TRA") introduced section 367(e)(2) of the Code, which changed the rules for taxing corporations on distributions they make in liquidation. Prior to “TRA”, corporations were not taxed on distributions of appreciated property in complete liquidation, although non-liquidating distributions of the same property, with several exceptions, resulted in corporate-level tax. In part to eliminate this disparity, the law now generally taxes corporations on the liquidating distribution of appreciated property. The Code provides an exception in the case of distributions by 80 percent or more controlled subsidiaries to their parent corporations, on the theory that the built-in gain in the asset will be recognized when the parent

sells or distributes the asset. The policy of the Code is to collect one corporate-level tax on the liquidating distribution of appreciated property; if and only if that tax can be collected on a subsequent sale or distribution does the Code defer the tax. Thus, the exception does not apply to distributions to parent corporations which are tax-exempt organizations or, except to the extent provided in regulations, foreign corporations. It is understood that the inapplicability of the exception to the tax on distributions to foreign parent corporations does not conflict with paragraph 4 of the Article. While a liquidating distribution to a U.S. parent will not be currently taxed, and, except to the extent provided in regulations, a liquidating distribution to a foreign parent will, paragraph 4 merely prohibits discrimination among corporate taxpayers on the basis of U.S. or foreign stock ownership. Eligibility for the exception to the tax on liquidating distributions for distributions to nonexempt, U.S. corporate parents is not based upon the nationality of the owners of the distributing corporation, but rather is based upon whether such owners would be subject to corporate tax if they subsequently sold or distributed the same property. Thus, the exception does not apply to distributions to persons which would not be so subject-not only foreign corporations, but also tax-exempt organizations and individuals.

For the reasons given above in connection with the discussion of paragraph 2 of the Article, it is also understood that the provision in section 1446 of the Code for withholding of tax on non-U.S. partners does not violate paragraph 4 of the Article.

It is further understood that the ineligibility of a U.S. corporation with nonresident alien shareholders to make an election to be an "S" corporation does not violate paragraph 4 of the Article. If a corporation elects to be an S corporation (requiring 35 or fewer shareholders), it is generally not subject to income tax and the shareholders take into account their pro rata shares of the corporation's items of income, loss, deduction or credit. (The purpose of the provision is to allow an individual or small group of individuals to conduct business in corporate form while paying taxes at individual rates as if the business were conducted directly.) A nonresident alien does not pay U.S. tax on a net basis, and, thus, does not generally take into account items of loss, deduction or credit. Thus, the S corporation provisions do not exclude corporations with nonresident alien shareholders because such shareholders are foreign, but only because they are not net basis taxpayers. The provisions also exclude corporations with other types of shareholders where the purpose of the provisions cannot be fulfilled or their mechanics implemented. For example, corporations with corporate shareholders are excluded because the purpose of the provisions to permit individuals to conduct a business in corporate form at individual tax rates would not be furthered by their inclusion.

Paragraph 5 of the Article specifies that no provision of the Article will prevent either Contracting State from imposing the branch tax described in paragraph 8 of Article 10 (Dividends).

The saving clause does not apply to this Article. Thus, for example, a U.S. citizen who is resident in Finland may claim benefits in the United States under this Article.

Paragraph 6 provides that, notwithstanding the more limited coverage of the Treaty generally under Article 2 (Taxes Covered), this Article applies to all taxes imposed by a Contracting State or a political subdivision, statutory body or local authority thereof. Customs

duties are not considered to be taxes for this purpose.

ARTICLE 25
Mutual Agreement Procedure

Paragraph 1 provides that a resident or national of a Contracting State which considers that the actions of one or both of the Contracting States result or will result in taxation not in accordance with the Treaty may present the case to the competent authority of the Contracting State of which the person is a resident or national. The person need not have exhausted internal law remedies before presenting the case to the competent authorities.

Paragraph 2 provides that the competent authority of the Contracting State to which the case has been presented, if it considers the objection to be justified and if it is not able to arrive at a solution itself, shall endeavor to resolve the case by mutual agreement with the competent authority of the other Contracting State in order to avoid taxation not in accordance with the Treaty. Any agreement reached shall be implemented without regard to any statutory time limits or other procedural limitations in the national law of the Contracting States, provided that the competent authority of the Contracting State asked to waive its procedural limitations received notice of the existence of the case within six years. The notification may be given by the competent authority of the other Contracting State, the taxpayer who has requested the competent authority to take action, or a person related to the taxpayer. The notification must be in writing and must give sufficient details regarding the case to apprize the competent authority receiving the notification of the nature of that case. Thus, if it is agreed that tax liability should be adjusted downward, a refund of the excess tax paid will be made even though the statute of limitations of the Contracting State called upon to make the refund may have expired, so long as such Contracting State was notified of the existence of the case within the applicable time period. This waiver of the statute of limitations applies only for refunds and not for the imposition of additional taxes, because, pursuant to paragraph 2(a) of Article 1 (Personal Scope), the Treaty cannot operate to increase tax.

Paragraph 3 provides that the competent authorities shall endeavor to resolve by mutual agreement any difficulties or doubts which may arise in the interpretation or application of the Treaty. They may also consult together to reach agreements on rules, guidelines or procedures for the elimination of double taxation in cases not specifically provided for in the Treaty. This paragraph gives examples of the kinds of issues on which the competent authorities may reach agreement. These include:

(a) the same attribution of income, deductions, credits, or allowances of an enterprise of a Contracting State to its permanent establishment in the other Contracting State;
(b) the same allocation of income, deductions, credits, or allowances between persons;
(c) the same characterization of particular items of income;
(d) the same application of source rules; and
(e) a common meaning of a term.

The competent authorities may agree to increases in specific amounts of money referred to in the Treaty in order to reflect economic and monetary developments. For example, they may agree to

increase the $20,000 threshold for the taxation of artists and sportsmen in paragraph 1 of Article 17 (Artistes and Sportsmen). They may also discuss the application of the provisions of domestic law regarding non-criminal penalties and fines, and interest on deficiencies and refunds in a manner consistent with the purposes of the Treaty. The competent authorities may also consult for the purpose of eliminating double taxation in cases not provided for in the Treaty. For example, although this Treaty does not provide for the granting of a foreign tax credit to a permanent establishment by the country in which the permanent establishment is located, the competent authorities may agree to grant such a credit to relieve double taxation.

Paragraph 4 provides that the competent authorities may communicate with each other directly for the purpose of reaching agreement in accordance with this Article.

ARTICLE 26
Exchange of Information

This Article forms the basis for cooperation between the two countries in their attempts to deal with avoidance or evasion of their respective taxes and to obtain information so that they can properly administer the Treaty.

Paragraph 1 provides that the competent authorities shall exchange such information as is necessary for carrying out the provisions of the Treaty or of their domestic laws concerning taxes covered by the Treaty. It also provides assurances that information so exchanged will be protected against disclosure in the same manner as information obtained under national laws. Exchanged information may be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment, collection, or administration of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes to which the Treaty applies. Such persons or authorities can use the information for such purposes only. They may disclose the information in public court proceedings or in judicial decisions. Persons involved in the administration of taxes include legislative bodies involved in the oversight of the administration of taxes, including their agents such as, for example, the U.S. General Accounting Office or the tax-writing committee of Congress with respect to such information as they consider necessary to carry out their oversight responsibilities. Information may be exchanged with respect to persons who are not residents of either Contracting State.

Paragraph 2 explains that the obligation undertaken in paragraph 1 to exchange information does not require a Contracting State to carry out measures contrary to the laws and administrative practice of either Contracting State or to supply information not obtainable under either Contracting State's laws or in the normal course of its administration, or to supply information which would disclose trade secrets or other information the disclosure of which would be contrary to public policy.

Paragraph 3 states that, when information is requested by a Contracting State in accordance with this Article, the other State shall obtain the information as if the tax in question were a tax of that other State. That is, the requested State is obligated to acquire and transmit the information, subject to the rules of paragraph 2, even if it has no tax interest in the case. Further,

the paragraph specifies that the State to which a request has been made shall provide information if specifically requested, in forms usable in the judicial practice of the requesting State, such as depositions of witnesses and copies or unedited original documents, to the extent that such forms of information can be obtained under the laws and practices of the State to which the request is made when enforcing its own tax laws.

In paragraph 4 the Contracting States agree to endeavor to collect amounts on behalf of the other State to the extent necessary to ensure that any relief granted by the Treaty is not enjoyed by persons not entitled to the benefits of the Treaty. Thus, for example, if a dividend is paid to a resident of Finland, and U.S. tax had been withheld at the reduced 15 percent rate, if the recipient of the dividends is acting as a nominee on behalf of a third country resident, Finland is authorized to collect the additional 15 percent of tax on behalf of the United States. Paragraph 5 provides that paragraph 4 does not impose upon the Contracting States the obligation to carry out administrative measures different from, or contrary to the sovereignty, security or public policy of, those used in collecting its own taxes.

Paragraph 6 provides that, for purposes of this Article, notwithstanding the provisions of Article 2 (Taxes Covered), the Treaty applies to all taxes imposed by a Contracting State at the national level.

ARTICLE 27
Diplomatic Agents and Consular Officers

This Article, which generally corresponds to Article 27 of the U.S. Model, provides that the Treaty shall not affect taxation privileges of members of diplomatic missions or consular posts under special agreements or international law. Technical, administrative and service staff (but not including locally employed persons) are entitled to benefits under this Article.

ARTICLE 28
Entry into Force

Paragraph 1 provides that the Treaty be ratified by the Contracting States in accordance with their applicable procedures and obligates the Contracting States to notify each other as soon as possible that those procedures have been complied with.

Paragraph 2 provides that the Convention will enter into force 30 days after the date of the later of the notifications referred to in the previous paragraph. Once the Treaty enters into force it will have effect:

(a) in the United States with respect to taxes withheld at source, for amounts paid or credited on or after the first day of the second month next following the date on which the Treaty enters into force, and in respect of other taxes, for taxable years beginning on or after the first day of January next following the date on which the Treaty enters into force; and

(b) in Finland, in respect of taxes withheld at the source, on income derived on or

after the first of January next following the entry into force of the Treaty, and in respect of other taxes, for taxes chargeable for any taxable year beginning on or after January 1 of the year next following entry into force of the Treaty.

Paragraph 3 provides that upon the coming into effect of the Treaty, the Treaty between Finland and the United States with respect to taxes on income and property signed March 6, 1970 (the 1970 Treaty) will terminate. The provisions of the 1970 Treaty will cease to have effect from the date on which the corresponding provisions of this Treaty will have effect for the first time in accordance with the provisions of paragraph 2 of this Article.

ARTICLE 29
Termination

The Treaty shall remain in force indefinitely unless terminated by one of the Contracting States. Either Contracting State may terminate the Treaty after five years from the date on which it enters into force by giving at least six months' prior notice through diplomatic channels. In that event, in the United States, the Treaty will cease to have effect, in respect of taxes withheld at source, for amounts paid or credited on or after the first of January next following the expiration of the six months' period of notice, and in respect of other taxes, for taxable years beginning on or after the first day of January next following the expiration of the six months' period of notice (i.e., if notice is given by June 30 of one year, the termination will be effective on January 1 of the following year). In Finland, the Treaty will cease to have effect, in respect of taxes withheld at source, on income derived on or after the first of January next following the year in which the notice is given and, in respect to other taxes, the Treaty ceases to have effect for taxes chargeable for any taxable year beginning on or after January 1 in the year following that in which the notice is given.

June 14, 1990