



## Elimination of Withholding Taxes on Dividend, Interest and Royalties under U.S. Model Treaty

### Issue

An update of the U.S. Model Treaty is warranted to reflect the recent positive developments in the treatment of dividends under the pending U.S.-U.K. treaty and the pending Protocols with Australia and Mexico.

### Background

The United States Model Income Tax Convention of September 20, 1996 provides the following withholding tax rates on dividends, interest and royalties income, so long as such income is not attributable to a permanent establishment of the taxpayer and all other prerequisites are met:

**Dividends:** 5 percent for corporate shareholders with at least 10 percent ownership of voting stock; 15 percent for other shareholders.

**Interest:** Zero

**Royalties:** Zero

The pending income tax treaty concluded between the U.S. and the U.K., however, would provide for the first time in any U.S. tax treaty, a complete exemption from withholding taxes on dividends received from a subsidiary company that is at least 80 percent-owned and meets certain other criteria. If ratified, the withholding tax provisions of the new U.S.-U.K. treaty generally will enter into force on the first day of the second month following the exchange of instruments of ratification.

A similar zero percent dividend withholding provision, effective the later of July 1, 2003 or the first day of the second month following the exchange of instruments of ratification, was negotiated as a Protocol.

It is expected that the U.S. Senate could consider ratification of these agreements sometime this year.

### Policy Considerations

The U.S. Model Treaty generally reflects the current approach of the U.S. Treasury Department in bilateral tax treaties. The U.S. Model Treaty has been updated from time to time to reflect further consideration of various provisions in light of experience, subsequent treaty negotiations, economic, judicial, legislative or regulatory developments in the U.S., and changes in the nature or significance of transactions between U.S. and foreign persons.

The elimination of withholding taxes on dividends, interest and royalties would provide a more efficient movement of capital for U.S. companies in an increasingly competitive global economy. It would also reduce the complexities relating to administering domestic and foreign withholding taxes.

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### **Recommendation**

The SVTDG supports recent efforts by the U.S. government to negotiate tax treaties that provide for zero withholding rates for dividend income, consistent with the Model Treaty treatment of interest and royalties. The SVTDG recommends that this approach be incorporated within the U.S. Model Treaty.