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**TREASURY DEPARTMENT TECHNICAL EXPLANATION OF THE
CONVENTION AND PROTOCOL BETWEEN THE
UNITED STATES OF AMERICA AND UKRAINE
FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE
PREVENTION OF FISCAL EVASION WITH RESPECT TO
TAXES ON INCOME AND CAPITAL SIGNED AT WASHINGTON ON
MARCH 4, 1994**

INTRODUCTION

This is a technical explanation of the Convention and Protocol between the United States and Ukraine signed on March 4, 1994 ("the Convention"). The Convention replaces the Convention Between the United States of America and the Union of Soviet Socialist Republics for the Avoidance of Double Taxation of Income, the Prevention of Fiscal Evasion with Respect to Taxes on Income, and the Elimination of Obstacles to International Trade and Investment, signed on June 20, 1973 ("the 1973 Convention"), as it applied to the United States and Ukraine.

The Convention is based on the Model Double Taxation Convention on Income and Capital, published by the OECD in 1992 ("the OECD Model"), the 1973 Convention and other more recent US income tax conventions.

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

The explanations of each article include explanations of any Protocol provision relating to that article.

Article 1. GENERAL SCOPE

Paragraph 1 provides that the Convention applies to residents of the United States or Ukraine, and in some cases may also apply to residents of third States. Article 4 defines residents of the United States and Ukraine for the purposes of the Convention. Examples of cases where the Convention may affect residents of third States include the articles on non-discrimination (Article 25) and the exchange of information (Article 27).

Paragraph 2 provides that the Convention may not increase the tax burden of residents of either State compared to what it would be under the respective domestic law provisions. Thus, a right to tax given by the Convention cannot be exercised unless domestic law also provides for such a tax. This does not mean, however, that a taxpayer may pick and choose among Code and Convention provisions in an inconsistent manner in order to minimize tax. For example, assume a resident of Ukraine has three separate businesses in the United States. One is a profitable permanent establishment and the other two are trades or businesses that would earn income taxable in the United States under the Code but do not meet the permanent establishment threshold tests of the Convention. One is profitable, and the other incurs a loss. Under the Convention the income of the permanent establishment is taxable, and both the profit and loss of the other two businesses are ignored. Under the Code all three would be taxable. The loss would be offset against the profits of the two profitable ventures. The taxpayer may not invoke the Convention to exclude the profits of the profitable trade or business and invoke the Code to claim the loss of the loss trade or business against the profit of the permanent establishment. (See Rev. Rul. 84-17, 1984-1 C.B. 10.) If the taxpayer invokes the Code for the taxation of all three ventures, he would not be precluded from invoking the Convention with respect, for example, to any dividend income he may receive from the United States that is not effectively connected with any of his business activities in the United States.

Under subparagraph 2 b), the Convention also may not restrict a tax benefit conferred by any other agreement between the Contracting States. Under notes exchanged between the Contracting States on June 6, 1995 ("the Notes"), the Contracting States have agreed to a provision that specifically addresses on the relationship of the Convention to other agreements, including the General Agreement on Trade in Services ("GATS").

The United States is a party to "GATS" but Ukraine is not. Nevertheless, the Contracting States have considered the relationship between the Convention and GATS in the event that GATS should apply between them.

Article XXII(3) of GATS provides that a Member of the World Trade Organization may not invoke the obligation of national treatment under Article XVII of GATS with respect to a measure of another Member that falls within the scope of an international agreement between them relating to the avoidance of double taxation. In the case of a dispute between Members as to whether a measure falls within the scope of such an agreement between them, Article XXII(3), footnote 11 of GATS provides that, with respect to agreements on the avoidance of double taxation which exist on the date of entry into force of the WTO Agreement, the dispute may be brought before the Council for Trade in Services only with the consent of both parties to such an agreement.

Paragraph 1 of the Notes provides that, notwithstanding Article XXII(3) and footnote 11 of the GATS, in the event that the GATS applies between the Contracting States, a dispute concerning whether a measure is within the scope of the proposed Convention shall be considered only pursuant to Article 26 (Mutual Agreement Procedure) of the proposed Convention by the competent authorities as defined in subparagraph 1(j) of Article 3 (General Definitions) of the proposed Convention.

In addition, the Contracting States have considered the relationship between the Convention and other agreements that apply between them and that have provisions concerning national treatment or most-favored-nation treatment. Paragraph 2 of the Notes provides that, unless the competent authorities determine that a taxation measure is not within the scope of the proposed Convention, the national treatment or most-favored-nation ("MFN") obligations under any other agreement (including GATS in the event that it applies between the Contracting States) shall not apply to a taxation measure, subject to certain exceptions. These exceptions permit the application of such national treatment or MFN obligations as may apply to trade in goods under the Agreement on Trade Relations between the United States and Ukraine, and the General Agreement on Tariffs and Trade ("GATT"), if it applies between the United States and Ukraine.

Paragraph 3 contains the traditional "saving" clause, which provides that each country may tax in accordance with its domestic law, without regard to the Convention, its own residents, and in the case of the United States, its citizens, and former citizens. "Residence," for the purpose of the saving clause, is determined under Article 4 (Residence). Thus, for example, if an individual who is not a U.S. citizen is a resident of the United States under the Code, e.g., a "green card" holder, and is also a resident of Ukraine under Ukrainian law, and the tie-breaker rules of paragraph 2 of Article 4 determine that he is a resident of Ukraine, he will be entitled to U.S. benefits under the Convention. The paragraph also permits the taxation of certain former citizens by the United States whose loss of citizenship had as one of its principal purposes the avoidance of

U.S. tax, in accordance with section 877 of the Internal Revenue Code. There is not a comparable provision in Ukrainian law dealing with former citizens.

As a consequence of the saving clause, each article should be read as not providing benefits with respect to the U.S. taxation of U.S. citizens (wherever resident) or residents or with respect to Ukrainian taxation of Ukrainian residents. However, paragraph 4 provides certain exceptions to the saving clause. Under subparagraph a), for example, U.S. residents and citizens are entitled to certain U.S. benefits provided under the Convention. Those benefits are: the correlative adjustments authorized by paragraph 2 of Article 9, the exemption of social security benefits paid by the other State that is provided in paragraph 1 of Article 19, the guarantee of a foreign tax credit provided in Article 24, the nondiscrimination protection of Article 25 and the competent authority procedures of Article 26. Under subparagraph b) certain additional benefits are available to U.S. residents who are neither US citizens nor "green card" holders; these are the benefits extended to employees of the Ukrainian Government under Article 18, to visiting students, trainees and researchers under Article 20, and to members of diplomatic and consular missions under Article 28. This paragraph also applies reciprocally.

Article 2. TAXES COVERED.

This Article identifies the U.S. and Ukrainian taxes to which the Convention applies.

In the case of the United States, the Convention applies to the Federal income taxes imposed by the Internal Revenue Code, but not including the accumulated earnings tax or personal holding company tax (which are considered penalty taxes) or social security taxes. It also applies to the excise taxes imposed with respect to the investment income of private foundations. The non-discrimination provisions of Article 25 apply to all taxes imposed at all levels of government. It is the only article that applies to state and local taxes. The exchange of information provisions of Article 27 apply to all Federal level taxes, including estate and gift and excise taxes to the extent that such information is relevant to enforcement of the Convention or of any covered tax as long as such tax is applied in a manner that is not inconsistent with the Convention.

In the case of Ukraine, the Convention applies to the taxes on profits and income provided by the enumerated Ukrainian laws. The non-discrimination provisions of Article 25 extend to all taxes at all levels of government and the exchange of information provisions of Article 27 extend to all national-level taxes.

Under paragraph 2, the Convention will apply to any taxes that are substantially similar to those enumerated in paragraph 1, and that are imposed in addition to, or in place of, the existing taxes after March 4, 1994 (the date of signature of the Convention). In recognition of the fact that the Ukrainian tax system is evolving, the paragraph adds that a subsequent tax imposed by one State that is substantially similar to an existing tax of the other State covered by paragraph 1 will also be covered. For the same reason, paragraph 3 also includes in the Convention's coverage any national level tax on property subsequently imposed by either Contracting State.

Paragraph 2 also provides that the U.S. and Ukrainian competent authorities will notify each other of significant changes in their taxation laws that are of significance to the operation of the Convention, including changes that deny or have the effect of denying deductions for interest, wages and other significant business expenses.

Article 3. GENERAL DEFINITIONS

Paragraph 1 defines a number of basic terms used in the Convention. Certain others are defined in other articles of the Convention. For example, the term "resident of a Contracting State" is defined in Article 4 (Residence). The term "permanent establishment" is defined in Article 5 (Permanent Establishment). The terms "dividends," "interest" and "royalties" are defined in Articles 10, 11 and 12, respectively, which deal with the taxation of those classes of income.

The term "Contracting State" means the United States or Ukraine, depending on the context in which the term is used.

The terms "United States" and "Ukraine" are defined in subparagraphs b) and c), respectively. The term "United States" is defined to mean the United States of America. The term does not include Puerto Rico, the Virgin Islands, Guam or any other U.S. possession or territory. When used geographically, the "United States" includes the territorial sea, and any area outside the territorial sea that in accordance with international law has been or may be designated an area in which the United States may exercise rights with respect to the seabed and subsoil and their natural resources.

When used geographically the term "Ukraine" includes the territorial sea, and any area outside the territorial sea that in accordance with international law has been or may be designated an area in which the United States may exercise rights with respect to the seabed and subsoil and their natural resources.

Subparagraph d) defines the term "national" to include any individual possessing the nationality of a Contracting State, and

any legal person, partnership or association deriving its status as such from the laws in force in a Contracting State.

Subparagraph e) defines the term "person" to include an individual, an estate, a trust, a partnership, a company and any other body of persons. Any such person may be a "resident" of a Contracting State for purposes of Article 4 and thus entitled to the benefits of the Convention.

The term "company" is defined in subparagraph f) as any entity treated as a body corporate for tax purposes. In Ukraine, this includes a joint stock company, a limited liability company, a joint venture, and any other legal entity or an organization subject to the tax on profits in Ukraine. For U.S. tax purposes, the rules of Treas. Reg. § 301.7701-2 generally will be applied to determine whether an entity is a body corporate. However, Ukrainian entities described in the second sentence of subparagraph f) are treated as companies for all purposes of the treaty.

Subparagraph g) defines the term "international traffic." The term means any transport by a ship or aircraft except when such transport is solely between places within a Contracting State. The exclusion from international traffic of transport solely between places within a Contracting State means, for example, that the transport of goods or passengers solely between New York and Chicago by a Ukrainian carrier (if it were permitted) would not be treated as international traffic, and the resulting income would not be exempt from U.S. tax under Article 8. It would however, be treated as business profits under Article 7 and would, therefore, be taxable in the United States only if attributable to a U.S. permanent establishment, and then only on a net basis. If, however, goods or passengers are carried by a Ukrainian airplane from Kiev to New York and then to Chicago, the trip would be international transport with respect to the carriage for those who continued to Chicago as well as for those who disembarked in New York.

Subparagraph h) defines the term "property." The definition is relevant for possible future enactment of a tax on capital by either Contracting State. (See Article 23 (Property).)

The terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" are defined in subparagraph i) as an enterprise carried on by a resident of one of the States and an enterprise carried on by a resident of the other State, respectively. The term "enterprise" is not defined in the Convention.

The "competent authority" is the Government official charged with administering the provisions of the Convention and with attempting to resolve any doubts or difficulties that may arise

in interpreting its provisions. The U.S. competent authority is the Secretary of the Treasury or his authorized representative. The Secretary of the Treasury has delegated the competent authority function to the Commissioner of Internal Revenue, who has, in turn, delegated the authority to the Assistant Commissioner (International). With respect to interpretive issues, the Assistant Commissioner acts with the concurrence of the Associate Chief Counsel (International) of the Internal Revenue Service. In Ukraine, the competent authority is the Minister of Finance or his authorized representative.

Paragraph 2 provides that, in the application of the Convention, any term used but not defined in the Convention will have the meaning that it has under the law of the Contracting State whose tax is being applied, unless the context requires a different interpretation or the competent authorities agree to a common meaning.

Article 4. RESIDENCE

This Article sets forth rules for determining whether a person is a resident of a Contracting State for purposes of the Convention. Determination of residence is important because, as noted in the explanation to Article 1 (General Scope), as a general matter only residents of the Contracting States may, subject to Article 22 (Limitation on Benefits), claim the benefits of the Convention. This definition of residence is to be used only for purposes of the Convention.

The determination of residence for purposes of the Convention looks first to a person's liability to tax as a resident under the respective taxation laws of the Contracting States. For this purpose, liability to tax is interpreted as subject to the taxation laws; thus, a tax-exempt entity may be a resident of a Contracting State. A person who, under those laws, is a resident of one Contracting State and not of the other need look no further. That person is a resident for purposes of the Convention of the State in which he is resident under internal law. Consistent with U.S. treaty policy, the Convention includes citizenship as one of the criteria of residence. Thus, a U.S. citizen resident in a third country is entitled to the benefits of this Convention on the same basis as an individual residing in the United States. If, however, a U.S. citizen or resident (e.g., a "green card" holder) is also a resident of Ukraine under its taxation law, the individual must look to the tie-breaker rules of paragraph 2, which attempt to assign one State of residence to such a person for purposes of the Convention. A U.S. citizen would continue to be subject to U.S. taxation under the saving clause of paragraph 3 of Article 1 (General Scope), but a green card holder's residence would be determined only under this Article for purposes of Convention benefits.

It is understood that the two Contracting States and their political subdivisions are to be treated as residents of those States for purposes of the Convention.

A person that is liable to tax in a Contracting State only in respect of income from sources within that State will not be treated as a resident of that State for purposes of the Convention. Thus, for example, a Ukrainian consular official in the United States who is subject to U.S. tax on U.S. source investment income, but not on non-U.S. income, would not be considered a resident of the United States for purposes of the Convention. (In most cases such an individual also would not be a U.S. resident under the Code.)

Paragraph 1 of the Protocol provides that a partnership, estate or trust will be treated as a resident of a Contracting State in accordance with the residence of the person liable to tax with respect to the income derived by the partnership, estate, or trust, *i.e.*, to the extent that the income is taxed as the income of a resident, whether in the hands of the person deriving the income or in the hands of its partners or beneficiaries. This rule is applied to determine the extent to which the partnership, estate or trust is entitled to benefits with respect to income derived from the other Contracting State. Under Ukrainian law a partnership is generally taxed as an entity, and trusts and estates are not used. Under U.S. law, a partnership is never (except for certain publicly traded limited partnerships and partnerships that are reclassified as associations under Treas. Reg. § 301.7701-2), and an estate or trust is often not, a taxable entity. Thus for purposes of the Convention, income received by a U.S. partnership need only be treated as received by a U.S. resident to the extent included in the distributive share of partners who are U.S. residents (looking through any partnerships that are themselves partners). Similarly, the treatment under the Convention of income received by a U.S. trust or estate will be determined by the residence for taxation purposes of the person subject to tax on such income, which may be the grantor, the beneficiaries, or the estate or trust itself, depending on the particular circumstances.

If, under the laws of the two Contracting States, and, thus, under paragraph 1, an individual is deemed to be a resident of both Contracting States, a series of tie-breaker rules is provided in paragraph 2 to determine a single State of residence for that individual. These rules come from the OECD Model. The first test applies if the individual has a permanent home. If that test is inconclusive because the individual has a permanent home available to him in both States, he will be considered to be a resident of the Contracting State where his personal and economic relations are closest, *i.e.*, the location of his "center of vital interests." If that test is also inconclusive, or if he does not have a permanent home available to him in either State, he will be treated as a resident of the Contracting State where

he maintains an habitual abode. If he has an habitual abode in both States or in neither of them, he will be treated as a resident of his Contracting State of citizenship. If he is a citizen of both States or of neither, the competent authorities are instructed to resolve his residence by mutual agreement.

Paragraph 3 provides that if a person, other than an individual, is a resident of both Contracting States under their respective laws, the competent authorities will attempt to establish a single country of residence and agree on how the Convention is to apply to such a person.

Article 5. PERMANENT ESTABLISHMENT

This Article defines the term "permanent establishment," which is relevant to several articles of the Convention. The current or former existence of a permanent establishment in a Contracting State is necessary under Article 7 (Business Profits) for that State to tax the business profits of a resident of the other Contracting State. Articles 10, 11 and 12 (dealing with dividends, interest, and royalties, respectively) provide for reduced rates of tax at source on payments of these items of income to a resident of the other State only when the income is not attributable to a permanent establishment or fixed base which the recipient has in the source State; if the income is or was attributable to a permanent establishment, Article 7 (Business Profits) applies (and if the income is or was attributable to a fixed base, Article 14 (Independent Personal Services) applies).

This Article is similar in most respects to the corresponding Article of the OECD Model.

Paragraph 1 provides the basic definition of the term "permanent establishment." As used in the Convention, the term means a fixed place of business through which a resident of one Contracting State either wholly or in part carries on business activities in the other Contracting State. It is not necessary that the resident be a legal entity. In the case of an individual, Article 14 (Independent Personal Services) uses the concept of a "fixed base" rather than a "permanent establishment," but the two concepts are considered to be parallel.

Paragraph 2 contains a list of examples of fixed places of business which constitute a permanent establishment: a place of management, a branch, an office, a factory, a workshop, and a mine, well, quarry or other place of extraction of natural resources.

Paragraph 3 adds that a construction site, installation or assembly project, or an installation or drilling rig or ship used to explore for or exploit natural resources also constitutes a

permanent establishment, but only if it lasts more than 6 months. Although shorter than the period provided in some recent treaties, such as the treaty with the Russian Federation, this period is longer than the period provided in some other treaties with less-developed states, such as the 120 day period provided in the tax treaty with India. This period therefore may be considered to be consistent with recent U.S. treaty policy in treaties with developing countries. Further, pursuant to Article 29 (Entry into Force), during the first taxable year in which the Convention is in effect, a taxpayer may claim the benefit of the longer period provided in the 1973 Convention (but only beyond the end of that first taxable year to the extent consistent with the six month period provided in the Convention).

The 6-month test applies separately to each individual site or project. The period begins when work (including preparatory work carried on by the resident) physically begins in a Contracting State. A series of contracts or projects that are interdependent both commercially and geographically is to be treated as a single project. For example, the construction of a housing development would be considered a single project even if each house is constructed for a different purchaser. If the 6-month threshold is exceeded, the site or project constitutes a permanent establishment from its first day. This interpretation of the Article is based on the Commentaries to paragraph 3 of Article 5 of the OECD Model, which constitute the generally accepted international interpretation of the language in paragraph 3 of Article 5 of the Convention. Drilling rigs, both onshore and offshore, are covered by this rule, and must, therefore, be present in a Contracting State for 6 months to constitute a permanent establishment.

Paragraph 4 contains exceptions to the general rule of paragraph 1 that a fixed place of business through which a business is carried on constitutes a permanent establishment. The paragraph lists a number of activities that may be carried on through a fixed place of business, but that, nevertheless, will not give rise to a permanent establishment. The use of facilities solely to store, display or deliver merchandise belonging to an enterprise will not constitute a permanent establishment of that enterprise. The maintenance of a stock of goods belonging to an enterprise solely for the purpose of storage, display or delivery, or solely for the purpose of processing by another enterprise will not give rise to a permanent establishment of the first-mentioned enterprise. The maintenance of a fixed place of business solely for purchasing goods or collecting information for the resident, or for carrying out any other activity of a preparatory or auxiliary character for the resident, such as advertising, the supply of information, or certain research activities, will not constitute a permanent establishment of the resident. A combination of the activities described in paragraph 4 will not give rise to a permanent

establishment.

Paragraphs 5 and 6 specify when the use of an agent will constitute a permanent establishment where a permanent establishment does not otherwise exist under paragraphs 1 through 4. Under paragraph 5, a dependent agent of an enterprise will be deemed to be a permanent establishment of the enterprise, if the agent has and habitually exercises an authority to conclude contracts in the name of that enterprise. If, however, his activities are limited to those activities specified in paragraph 4 that would not constitute a permanent establishment if carried on directly by the enterprise through a fixed place of business, the agent will not be a permanent establishment of the enterprise.

Under paragraph 6, an enterprise will not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through an independent agent, including a broker or general commission agent, if the agent is acting in the ordinary course of his business.

Paragraph 7 clarifies that a company that is a resident of a Contracting State will not be deemed to have a permanent establishment in the other Contracting State merely because it controls, or is controlled by, a company that is a resident of that other Contracting State, or that carries on business in that other Contracting State. The determination of whether a permanent establishment exists will be made solely on the basis of the factors described in paragraphs 1 through 6 of the Article. Whether a company is a permanent establishment of a related company, therefore, is based solely on those factors and not on the ownership or control relationship between the companies.

Article 6. INCOME FROM REAL PROPERTY

Paragraph 1 provides the standard income tax treaty rule that income derived by a resident of Contracting State from real property, including income from agriculture or forestry, located in the other Contracting State may be taxed in that other State. The income may also be taxed in the State of residence.

Paragraph 2 defines real property in accordance with the laws of the Contracting States, but provides that it includes, in any case, property accessory to real property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of real property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources. The term does not include ships, boats and aircraft.

Paragraph 3 clarifies that the Article covers income from any use of real property, without regard to the form of exploitation, including leasing or sub-leasing.

Paragraph 4 is based on a corresponding provision in the OECD Model, clarifying that paragraphs 1 and 3 of this Article also apply to income from real property of an enterprise and to income from real property used for the performance of independent personal services.

Paragraph 5 provides for a binding election by the taxpayer to be taxed on a net basis. The election reflects U.S. treaty policy and U.S. law. Since this Article provides for net basis taxation, it generally provides the same tax result as Article 7 (Business Profits).

Article 7. BUSINESS PROFITS

This Article provides the rules for the taxation by a Contracting State of the business profits of a resident of the other Contracting State. The general rule under paragraph 1 is that business profits (as defined in paragraph 6) of a resident of one Contracting State may not be taxed by the other Contracting State unless the resident carries on or has carried on business in that other Contracting State through a permanent establishment (as defined in Article 5 (Permanent Establishment)) situated in the latter State. Where that condition is met, the State in which the permanent establishment is situated may tax the business profits attributable to the assets or activity of that permanent establishment.

Subparagraph a) of paragraph 2 of the Protocol to the Convention provides an example of the "attributable to" concept. The example concerns a company that is engaged in oil production through wells located in the other State. The company also carries on exploration activities at another location in that other State using assets and employees not connected with the production activities; the activities last less than 6 months. The company also occasionally leases drilling equipment to third parties. The three activities are separate. The oil production constitutes a permanent establishment and the resulting profits are taxable in that other State. The other two activities do not constitute permanent establishments, and any resulting profits may not be taxed in that other State.

Paragraph 2 provides that the Contracting States will attribute to a permanent establishment the profits that it would be expected to make if it were an independent entity, engaged in the same or similar activities under the same or similar conditions, and dealing wholly independently with the enterprise of which it is a permanent establishment and any other enterprise that is an associated enterprise within the meaning of Article 9

(Associated Enterprises). Profits so attributable to a permanent establishment are taxable in the State where the permanent establishment is situated or was situated at the time the profits were made. This rule incorporates the rule of section 864(c)(6) of the Internal Revenue Code with respect to deferred payments, which is also reflected in the provisions of Articles 11 (Interest), 12 (Royalties), 14 (Independent Personal Services) and 21 (Other Income) dealing with amounts attributable to a permanent establishment or fixed base. If the income was attributable to a permanent establishment or fixed base when earned, it is taxable by the State where the permanent establishment or fixed base was located, even if receipt of the income is deferred until the permanent establishment or fixed base has ceased to exist.

The profits attributable to a permanent establishment may be from sources within or without a Contracting State. Thus, certain items of foreign source income described in section 864(c)(4)(B) or (C) of the Code may be attributed to a U.S. permanent establishment of a Ukrainian resident and subject to tax in the United States. The concept of "attributable to" in the Convention is narrower than the concept of "effectively connected" in section 864(c) of the Code. The limited "force of attraction" rule in Code section 864(c)(3), therefore, is not applicable under the Convention.

Paragraph 3 provides that the tax base must be reduced by deductions for expenses incurred for the purposes of the permanent establishment. These include expenses directly incurred by the permanent establishment and a reasonable allocation of expenses incurred by the home office, or by other parts of the enterprise company, as long as the expenses were incurred for the purposes of the permanent establishment. Allocable expenses include executive and general administrative expenses, research and development expenses, interest, and charges for management, consultancy, or technical assistance, wherever incurred and without regard to whether they are actually reimbursed by the permanent establishment. As indicated in paragraph 2(b) of the Protocol, the expenses may be incurred by the home office of the permanent establishment, other permanent establishments in third countries, or the permanent establishment itself. The permanent establishment must be able to document such expenses, if so requested by the tax authorities of the State in which it is located. In no case, however, will deductions be allowed for amounts paid by the permanent establishment to the home office or other permanent establishments in respect of deductible expenses such as interest, royalties, and service fees. Rather, the permanent establishment will be allowed deductions for such expenses only to the extent they are reasonably allocable to the permanent establishment, as described above.

Paragraph 4 provides that the business profits attributable to a permanent establishment shall be determined by the same method from year to year unless there is a good and sufficient reason to the contrary.

Paragraph 5 provides that no business profits will be attributed to a permanent establishment merely because it purchases goods or merchandise for the resident of which it is a permanent establishment. This rule refers to a permanent establishment that performs more than one function for the enterprise, including purchasing. For example, the permanent establishment may purchase raw materials for the enterprise's manufacturing operation and sell the manufactured output. While business profits may be attributable to the permanent establishment with respect to its sales activities, no profits are attributable with respect to its purchasing activities. If the sole activity were the purchasing of goods or merchandise for the enterprise, the issue of the attribution of income would not arise, because under subparagraph 4(d) of Article 5 (Permanent Establishment) there would be no permanent establishment.

Paragraph 6 illustrates the meaning of the term "business profits" as used in this Article. It includes income from the active conduct of business, such as rental of tangible movable (personal) property and income from furnishing the services of others. It does not include compensation for personal services of individuals, whether self-employed or as employees.

Paragraph 7 coordinates the provisions of this Article and other provisions of the Convention. Under paragraph 7, where business profits include items of income that are dealt with separately under other articles of the Convention, the provisions of those articles will, except where they specifically provide to the contrary, take precedence over the provisions of Article 7 (Business Profits). Thus, for example, the taxation of interest will be determined by the rules of Article 11 (Interest) except where, as provided in paragraph 3 of Article 11, the interest is attributable to a permanent establishment, in which case the provisions of Article 7 apply.

Article 8. SHIPPING AND AIR TRANSPORT

This Article provides the rules that govern the taxation of income from the operation of ships and aircraft in international traffic. "International traffic" is defined in subparagraph 1 g) of Article 3 (General Definitions). Such income, when derived by a resident of either Contracting State, may be taxed only by that State, the country of residence. If the other Contracting State is the country where the income arises, it must exempt the income from tax, even if it is attributable to a permanent establishment in that State.

Income from the rental of ships or planes on a full basis for use in international traffic is considered operating income and is covered under paragraph 1. Income from the bareboat leasing of ships or planes is also exempt from tax at source if the ships or aircraft are used in international traffic by the lessee. In such a case, it does not matter whether the lessor carries on a business of operating ships or planes; the same rule applies to a leasing company. However, if the lessor is an operating company, and the income is incidental to income from such operations, the exemption extends also to income from the rental of ships or aircraft used in domestic traffic by the lessee. Income from the leasing or use of containers in international traffic is also exempt from tax at source under this Article, whether derived by an operating company or by a leasing company. Gain from the alienation of containers and related equipment that are used in international traffic are exempt if such gain is incidental to income from the use or rental of such equipment. Further, gain from the alienation of ships or aircraft operated in international traffic is exempt from tax at source if such gain is incidental to income from the operation by the resident of ships or aircraft in international traffic.

Paragraph 3 clarifies that the provisions of paragraphs 1 and 2 apply to income from participation in a pool, joint business, or international transportation agency. For example, if a Ukrainian airline were to form a consortium with other national airlines, the Ukrainian participant's share of the income derived from U.S. sources would be covered by this Article.

Article 9. ASSOCIATED ENTERPRISES

This Article provides that when two related persons that are residents of the two Contracting States engage in transactions that are not at arm's length, the Contracting States may make appropriate adjustments to the taxable income and tax liability of such persons to reflect the income or tax with respect to such transactions that each would have had if the relationship between them had been at arm's length.

Paragraph 1 deals with the circumstance where a resident of a Contracting State participates, directly or indirectly, in the management, control, or capital of a resident of the other Contracting State, or when the same persons participate directly or indirectly in the management, control, or capital of a resident of one of the Contracting States and any other person. The term "control" includes any kind of control, whether or not legally enforceable and however exercised or exercisable. If in either case transactions are entered into that are not at arm's length, the competent authorities may adjust the income of their residents to reflect what it would have been if they had been

independent of each other.

Paragraph 2 provides that, where a Contracting State has made an adjustment that is consistent with the provisions of paragraph 1, the other Contracting State will make a corresponding adjustment to the tax liability of the related person in that other State. Paragraph 2 of Article 26 (Mutual Agreement Procedure) explains that the corresponding adjustment will not be prevented by a domestic statute of limitations. It is understood that the other Contracting State need adjust its tax only if it agrees that the initial adjustment is appropriate. The other provisions of the Convention, where relevant, are to be taken into account. The competent authorities will consult, as necessary, in applying these provisions.

Paragraph 3 simply confirms that this Article does not restrict the provisions of either Contracting State's domestic law relating to adjustments between related persons. The reference in paragraph 1 to "income," for example, does not imply that adjustments may not relate to deductions, exemptions, credits, or other elements affecting the tax liability.

Article 10. DIVIDENDS

This Article provides rules for limiting the taxation at source of dividends paid by a company that is a resident of one Contracting State to a shareholder who is a resident of the other Contracting State. It also provides rules for the imposition of a tax at source on branch profits, analogous to the tax on dividends paid by a subsidiary company.

Paragraph 1 preserves the residence State's general right to tax its residents on dividends paid by a company that is a resident of the other Contracting State. The same result is achieved by the saving clause of paragraph 3 of Article 1 (General Scope).

Except as otherwise provided in paragraph 4, and in paragraph 3 of the Protocol (discussed below), paragraph 2 limits to 5 percent the tax imposed by the source State on direct investment dividends. A non-reciprocal definition of direct investment dividends has been adopted. In general, source state tax is limited to 5 percent if the beneficial owner of the dividend is a company resident in the other State that owns at least 10 percent of the voting stock of the paying corporation (or 10 percent of the authorized capital if the company does not have voting stock). However, in the case of dividends paid by a Ukrainian company, nonresidents of Ukraine must in total own at least 20 percent of the voting stock of the paying company (or 20 percent of the authorized capital if the company does not have voting stock) in order for the 5 percent limitation to apply. The 20 percent foreign ownership requirement may be satisfied by

any non-Ukrainian shareholder (not only U.S. shareholders). This requirement of 20 percent foreign ownership corresponds to provisions in Ukrainian law relating to foreign-owned joint ventures and eligibility for tax holidays. The United States did not insist that this requirement apply also to dividends paid by United States corporations because it is inconsistent with general U.S. treaty policy of withholding 5 percent of dividends paid to beneficial owners of 10 percent or more of the stock of the paying corporation, and it would be inconsistent with U.S. policy relating to limitation on benefits to confer an additional benefit on a 10 percent Ukrainian shareholder in a U.S. corporation only if an additional investor (potentially from a third state that is not a U.S. treaty partner) also invested in the paying corporation.

In other cases, the source State tax is limited to 15 percent of dividends beneficially owned by residents of the other State.

Paragraph 3 defines the term "dividends" as used in this Article. The term encompasses income from any shares or rights that are not debt claims and that participate in profits, plus income from other corporate rights treated for domestic law tax purposes as dividends in the country of residence of the distributing company, and income from other arrangements, even if debt claims, if such arrangements carry the right to participate in profits and the income is characterized as a dividend under the domestic law of the country of residence of the distributing company. The last case takes into account domestic law distinctions between debt and equity. The definition also confirms that distributions by a Ukrainian joint venture to the foreign participants are dividends for purposes of this Article. Thus, such distributions are eligible for the reduced tax rates specified in paragraph 2.

Paragraph 4 explains that, where dividends are attributable to a permanent establishment or fixed base that the beneficial owner maintains in the other State, they are not subject to the provisions of paragraphs 1 and 2 of this Article, but are covered by Article 7 (Business Profits) or Article 14 (Independent Personal Services), as appropriate. This is also the case if the permanent establishment or fixed base has ceased to exist when the dividends are received as long as the dividends were attributable to the permanent establishment or fixed base in the earlier year.

Paragraph 5 permits a Contracting State to impose a branch profits tax on a corporation that is a resident of the other State. The tax is in addition to the ordinary tax on business profits. The additional tax is imposed on the "dividend equivalent amount" of such profits at the 5 percent rate that would apply to dividends paid by a wholly-owned subsidiary

corporation to its parent. At present Ukraine does not impose such a tax. The U.S. tax will be imposed in accordance with section 884 of the Internal Revenue Code, or a successor statute, subject to the reduced rate provided for in this Article.

Paragraph 3 of the Protocol relaxes the limitations on source country taxation for dividends paid by a U.S. Regulated Investment Company (RIC) and a Real Estate Investment Trust (REIT). A dividend paid by a RIC is subject to the 15-percent portfolio dividend rate regardless of the percentage of voting shares of the RIC held by the recipient of the dividend. The 5-percent rate is intended to relieve multiple levels of corporate taxation. Since RICs do not pay corporate tax with respect to amounts distributed, the only tax imposed on their distributions is the shareholder-level tax. Moreover, a foreign shareholder could own a 10 percent interest in a RIC without owning a 10 percent interest in any company whose shares are held by the RIC. In the case of a dividend paid by a REIT, the domestic law rate applies, i.e., 30 percent.

Article 11. INTEREST

Paragraph 1 grants to each Contracting State the exclusive right (subject to paragraph 3) to tax interest derived and beneficially owned by its residents, without regard to source. Each Contracting State agrees to exempt from tax interest derived and beneficially owned by residents of the other State.

Paragraph 2 defines the term "interest" as used in the Convention to include income from debt claims of every kind other than those giving rise to dividends under paragraph 3 of Article 10 (Dividends), as well as income treated as interest by the taxation law of the source State. In particular, income from government securities, income from bonds or debentures, and any premiums or prizes attaching to such securities, bonds or debentures are considered interest. Interest on bank deposits and on loans secured by mortgages is also covered. The definition does not refer to penalties and fines for late payment, which are frequently explicitly excluded from the treaty definition of interest. Such amounts may be imposed in accordance with domestic law.

Paragraph 3 provides an exception from the rule of paragraph 1 in cases where the beneficial owner of the interest, a resident of one Contracting State, carries on business through a permanent establishment in the other Contracting State or performs independent personal services through a fixed base situated in that other State and the interest is attributable to that permanent establishment or fixed base. In such a case, the income is taxable to the permanent establishment or fixed base in accordance with the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services). This rule applies

even if the permanent establishment or fixed base no longer exists when the interest is received or accrued, as long as the interest would be attributable to the permanent establishment or fixed base if it had been paid or accrued in the earlier year.

Paragraph 4 provides that, if as a result of a special relationship between persons, the interest paid is excessive, Article 11 applies only to the amount of interest payments that would have been made absent such special relationship (*i.e.*, an arm's length interest payment). Any excess amount of interest paid remains taxable according to the domestic law of the source State, with due regard to the other provisions of the Convention. Thus, for example, if the excess amount would be treated as a distribution of profits, such amount could be taxed as a dividend rather than as interest, but the tax would be subject, if appropriate, to the rate limitations of paragraph 2 of Article 10 (Dividends).

Paragraph 4 of the Protocol reserves the right of the United States to tax an excess inclusion of a residual holder of a Real Estate Mortgage Investment Conduit (REMIC) in accordance with its law; thus, the tax on such an excess inclusion of a resident of Ukraine would be subject to the domestic rate of withholding tax, now 30 percent.

Because Article 11 provides for exemption at source of interest derived by a resident of the other Contracting State, the United States will not impose its tax on excess interest of a U.S. branch of a Ukrainian company (Code section 884(f)(1)(B)).

Article 12. ROYALTIES

Paragraph 1 grants to each Contracting State the right to tax royalties derived and beneficially owned by its residents, without regard to source. Paragraph 2 permits source taxation of royalties beneficially owned by a resident of the other State at a rate not to exceed 10 percent of the gross amount of the royalties paid.

Paragraph 3 defines the term "royalties" as used in the Convention to mean payments of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic, or scientific work, including computer software programs, video cassettes, and films and tapes for radio and television broadcasting. It also includes payments for the use of, or right to use, any patent, trademark, design or model, plan, secret formula or process, or other like right or property; or for information concerning industrial, commercial, or scientific experience. This definition does not refer to gain from the alienation of any right or property that is contingent on the productivity, use, or disposition of the property. Such gain is taxable only in the State in which the alienator is

resident under Article 13 (Gains from the Alienation of Property). Income from the leasing of tangible personal property is taxed under Article 7 (Business Profits).

Paragraph 4 provides an exception to the rule of paragraph 1 in cases where the beneficial owner of the royalties, a resident of one Contracting State, carries on business through a permanent establishment in the other Contracting State or performs independent personal services through a fixed base in that other State and the royalties are attributable to that permanent establishment or fixed base. In such a case, the royalties are taxable to the permanent establishment or fixed base in accordance with the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services). The same rule applies if the permanent establishment or fixed base has ceased to exist when the royalties are received, so long as the royalties were attributable to it in the earlier year.

Paragraph 5 provides a rule for determining the source of royalties. Royalties will be deemed to arise in a State if the payor is a resident of that State (including the State itself or a political subdivision thereof). However, if the payor has a permanent establishment or fixed base in a Contracting State, the liability to pay the royalties was incurred in connection with such permanent establishment or fixed base, and the royalties are borne by the permanent establishment or fixed base, the royalties will be considered to arise in the State in which the permanent establishment or fixed base is situated. Finally, if this rule does not operate to deem royalties as arising in either State, and the royalties relate to the use of intangible property (as defined in paragraph 3), they shall be deemed to arise in the State in which they are used. This source rule also applies for purposes of Article 24 (Relief from Double Taxation).

Paragraph 6 provides that, if as a result of a special relationship between persons, the royalty paid is excessive, Article 12 applies only to the amount of royalty payments that would have been made absent such special relationship (*i.e.*, an arm's length royalty payment). Any excess amount of royalties paid remains taxable according to the laws of the United States and Ukraine, respectively, with due regard to the other provisions of the Convention. If, for example, the excess amount is treated as a distribution of profits, such excess amount could be taxed as a dividend rather than as a royalty payment, but the tax imposed on the dividend payment will be subject, if appropriate, to the rate limitations of paragraph 2 of Article 10 (Dividends).

Article 13. GAINS FROM THE ALIENATION OF PROPERTY

Article 13 provides rules for source and residence country taxation of gains from the alienation of property.

Paragraph 1 preserves the situs country right to tax gains derived from the alienation of real property situated in the situs State (the "source State"). Thus, paragraph 1 permits gains derived by a resident of one State from the alienation of real property located in the other State to be taxed by such other State.

Paragraph 2 provides that the rule of paragraph 1 applies to shares of the stock of any company that consists principally of real property situated in a Contracting State, and a participation in any partnership, trust or estate to the extent attributable to real property situated in a Contracting State. In all events the term "real property situated in the other State" includes a United States real property interest in the United States, as that term is defined in section 897 of the Internal Revenue Code (or any successor statute). Thus, the United State preserves its right to collect the tax imposed by section 897 on gains derived by foreign persons from the disposition of United States real property interests, including gains arising from indirect dispositions described in section 897(h). For this purpose, the source rules under section 861(a)(5) shall determine whether a real property interest is situated in the United States.

Paragraph 3 provides that gains from the alienation of personal property that are attributable to a permanent establishment that an enterprise of one of the States maintains in the other State may be taxed in the other State. The same rule applies to a fixed base used for the purpose of performing independent personal services, and to gain from the alienation of a permanent establishment or fixed base described in this paragraph. This provision permits gains from the alienation by a resident of a State of an interest in a partnership, trust or estate that has a permanent establishment in the other State to be taxed as gains attributable to such permanent establishment. Thus, for example, the United States may tax gains derived from the disposition of an interest in a partnership that has a permanent establishment in the United States, regardless of whether the assets of such partnership consist of personal property as defined in Article 13.

Paragraph 4 provides that gains from the alienation of property other than that described in this Article shall be taxable only in the State of which the alienator is a resident. The rule in this paragraph is subject to the provisions of Article 8 (Shipping and Air Transport). Gains described in Article 8 are taxable in accordance with the provisions of that Article.

Article 14. INDEPENDENT PERSONAL SERVICES

The Convention deals in separate articles with different

classes of income from personal services. Article 14 deals with the general class of income from independent personal services, and Article 15 deals with the general class of income from employment (dependent personal services). Articles 16 through 20 provide exceptions and additions to these general rules for directors' fees (Article 16); income of artistes and sportsmen (Article 17); government service salaries (Article 18); pensions in respect of personal service income and social security benefits (Article 19); and certain income of students, trainees and researchers (Article 20).

Income derived by an individual who is a resident of one Contracting State from the performance of personal services in an independent capacity in the other Contracting State is exempt from tax in that other State unless two conditions are satisfied. The income may be taxed in that other State if the services are or were performed there (see Code section 864(c)(6)); and the income is attributable to a fixed base that is or was regularly available to the individual in that other State for the purpose of performing his services. If those two conditions are met, the income attributable to the fixed base also may be taxed by the State where the fixed base is located. The income attributed to the fixed base must be taxed on a net basis, after allowance of deductions for business expenses, in accordance with principles similar to those provided in Article 7 (Business Profits) for the taxation of business enterprises. However, in this case, only income from services performed in a Contracting State may be attributed to a fixed base in that State.

Paragraph 2 notes that the term "independent personal services" includes independent scientific, literary, artistic, educational or teaching activities, as well as the independent activities of physicians, lawyers, engineers, architects, dentists, and accountants. This list, which is derived from the OECD Model, is not exhaustive. The term includes all personal services performed by an individual for his own account, where he receives the income and bears the risk of loss arising from the services.

As indicated in paragraph 4 of Article 6 (Income from Real Property), the provisions of Article 6 rather than of Article 14 will apply to income from real property that is used for the performance of independent personal services.

Paragraph 5 of the Protocol acknowledges that the State of source may require a preliminary withholding of tax from income derived by residents of the other State, including but not limited to income referred to in this Article. Where there is a tentative withholding of tax, each State agrees to make timely refunds on application of the taxpayer if the Convention provides for a reduced rate or an exemption.

Article 15. DEPENDENT PERSONAL SERVICES

This Article deals with the taxation of remuneration derived by a resident of a Contracting State for the performance of personal services in the other Contracting State as an employee.

Under paragraph 1, remuneration derived by an employee who is a resident of a Contracting State may be taxed by his State of residence. This is the same result as achieved by paragraph 3 of Article 1 (General Scope). However, to the extent that the remuneration is derived from an employment exercised (the performance of services) in the other Contracting State, the remuneration also may be taxed by the other Contracting State if the conditions specified in paragraph 2 are satisfied.

Paragraph 1 also provides that the more specific rules of Articles 18 (Government Service), and 19 (Pensions) apply in the case of employment income described in one of these articles. Thus, even though the State of source has a right to tax employment income generally under Article 15, it may not have the right to tax a particular type of income under the Convention if that right is proscribed by one of the aforementioned articles.

Under paragraph 2, the Contracting State in which the services are performed may also tax the remuneration unless three conditions are satisfied: (1) the individual is present in that State for a period or periods not exceeding 183 days in the calendar year; (2) the remuneration is paid by, or on behalf of an employer who is not a resident of that Contracting State; and (3) the remuneration is not borne as a deductible (or capitalizable) expense by a permanent establishment or fixed base that the employer has in that State. If a foreign employer pays the salary of an employee, but a host country corporation or permanent establishment reimburses the foreign employer through a deductible payment that can be identified as a reimbursement, neither condition (2) nor (3), as the case may be, will be considered to have been fulfilled. Conditions (2) and (3) are intended to ensure that a Contracting State will not be required both to allow a deduction to the payor for the amount paid and to exempt the employee on the amount received. In order for the remuneration to be exempt from tax in the source State, all three conditions must be satisfied.

Paragraph 3 contains a special rule that provides for exemption from tax at source for remuneration for services performed as an employee aboard a ship or aircraft operated in international traffic. Such income is taxable only in the State of the employee's residence.

Article 16. DIRECTORS' FEES

This Article provides that a Contracting State may tax the

director's fees and similar payments paid by a company that is a resident of that State for services performed by a resident of the other Contracting State in his capacity as a director of the company. For this purpose, "similar payments" includes fixed salaries (or the portion thereof) paid for services performed as a director. Only the State of residence of the director, however, may tax any portion of the remuneration that is derived in respect of services performed in that State.

This article is subject to the provisions of the saving clause of paragraph 3 of Article 1 (General Scope).

Article 17. ARTISTES AND SPORTSMEN

This Article deals with the taxation by one State of artistes (*i.e.*, performing artists and entertainers) and sportsmen resident in the other State from the performance of their services as such. The Article applies both to the income of an entertainer or sportsman who performs services on his own behalf and one who performs his services on behalf of another person, either as an employee of that person, or pursuant to any other arrangement. The rules of this Article take precedence over those of Articles 14 (Independent Personal Services) and 15 (Dependent Personal Services). This Article applies, however, only with respect to the income of performing artists and sportsmen. Others involved in a performance or athletic event, such as producers, directors, technicians, managers, coaches, etc., remain subject to the provisions of Articles 14 and 15.

Paragraph 1 provides that income derived by a resident of one State from his personal activities as an entertainer or sportsmen exercised in the other State may be taxed in that other State. This provision corresponds to the OECD Model, but departs from most recent U.S. treaties in that the latter have introduced a dollar threshold test to distinguish between individuals who earn very high compensation in a short period of time, and modestly compensated individuals who are not clearly distinguishable from those who earn other types of personal service income. The potential inconsistency in treatment of modestly compensated artistes and sportsmen on the one hand and other categories of modestly compensated employees on the other is addressed in part, however, by paragraph 3 of this Article, which is discussed below.

Income derived from one State by an entertainer or sportsman who is a resident of the other in connection with his activities as such, but from other than actual performance, such as royalties from record sales and payments for product endorsements, is not covered by this Article, but by other articles of this Convention, such as Article 12 (Royalties).

Paragraph 2 is intended to eliminate the potential for abuse

when income from a performance by an entertainer or sportsman does not accrue to the performer himself, but to another person. Foreign entertainers commonly perform in the United States as employees of, or under contract with, a company or other person. The relationship may truly be one of employee and employer, with no abuse of the tax system either intended or realized. On the other hand, a nominal employer may be a company established and owned by the performer, and merely act as the nominal recipient of the remuneration for the employee's performance. The entertainer may be acting as a nominal employee for a nominal salary, and arrange to receive the remainder of the income from the performance at a later time or in another form. In such case, absent the provisions of paragraph 2, the company providing the entertainer's services could attempt to escape host country tax because it earns business profits but has no permanent establishment in that country.

Paragraph 2 prevents this type of abuse while protecting the taxpayer's rights to the benefits of the Convention when there is a legitimate employer-employee relationship between the performer and the person providing his services. Under paragraph 2, when the income accrues to a person other than the performer, and the performer (or persons related to him) participates, directly or indirectly, in the profits of that other person, the income may be taxed in the Contracting State where the performer's services are exercised, without regard to the provisions of the Convention concerning business profits (Article 7) or independent personal services (Article 14). Thus, even if the "employer" has no permanent establishment or fixed base in the host country, its income may be subject to tax there under the provisions of paragraph 2. Taxation under paragraph 2 is imposed on the person providing the services of the entertainer or sportsman. This paragraph does not affect the rules of paragraph 1, which apply to the entertainer or sportsman himself. To the extent of salary payments to the performer, which are treated under paragraph 1, the income taxable by virtue of paragraph 2 to the person providing his services is reduced.

For purposes of paragraph 2, income is deemed to accrue to another person (i.e., the person providing the services of the entertainer or sportsman) if that person has control over, or the right to receive, gross income in respect of the services of the entertainer or sportsman. Direct or indirect participation in the profits of a person may include, but is not limited to, the accrual or receipt of deferred remuneration, bonuses, fees, dividends, partnership income or other income or distributions.

Paragraph 2 does not apply if it is established that neither the entertainer or sportsman, nor any persons related to him, participate directly or indirectly in the profits of the person providing the services of the entertainer or athlete.

Paragraph 3 provides an exception to the rules of paragraphs 1 and 2. It exempts income of a resident of one of the Contracting States from tax in the State in which the artiste or sportsman performs his activities if the visit to that State is substantially supported by public funds of the State in which the artiste or sportsman resides, or the visit is made pursuant to an arrangement agreed to by the Contracting States (such as a cultural exchange). Thus, for example, if an orchestra or ballet troupe that is substantially supported by public funds in one of the States were to visit the other Contracting State, its members would not be subject to tax in the other Contracting State on their income from performing in the other Contracting State.

This article is subject to the provisions of the saving clause of paragraph 3 of Article 1 (General Scope).

Article 18. GOVERNMENT SERVICE

This Article follows the corresponding provisions of the OECD Model.

Paragraph 1 provides that payments from the public funds of a Contracting State or political subdivision or local authority to compensate an individual for performing governmental services generally may be taxed only by that State. However, if the individual is either a citizen of the other State, or did not become a resident of the other State solely for the purpose of taking the job, the compensation may be taxed only by that other State. It is understood that a governmental worker's spouse who takes a governmental job subsequent to becoming a resident of the host state, nevertheless will be considered to have become a resident of the host State solely for the purpose of taking a governmental job.

Paragraph 2 provides rules for the taxation of pensions paid from public funds in respect of governmental services. Such pensions may be taxed only by the paying State unless the individual is a resident and citizen of the other State, in which case the other (residence) State also may tax the pension (and must grant a foreign tax credit for any taxes paid to the paying State).

This rule does not apply to social security benefits and other public pensions that are not in respect of services rendered to the paying government or a political subdivision or local authority thereof; such amounts are taxed under Article 19 (Pensions). However, this rule does apply to social security payments to U.S. Government employees for whom the social security system is the retirement plan related to their government service; i.e., in the unusual case where a Ukrainian citizen and resident derives a pension for U.S. Government employment that is paid under the social security system, Ukraine

may tax that pension. This could happen, for example, if a locally hired driver for the U.S. Embassy in Kiev were to retire and receive a U.S. pension under social security.

The rules of paragraphs 1 and 2 are an exception to the saving clause of paragraph 3 of Article 1 (General Scope) for individuals who are neither citizens nor permanent residents of the State where the services are performed. Thus, for example, payments by Ukraine to its employees at the Ukrainian Embassy in Washington are exempt from U.S. tax if the employees are not U.S. citizens or green card holders and were not residents of the United States at the time they became employed by Ukraine, even if they would otherwise be considered U.S. residents for tax purposes. (Under the 1984 modification to the definition of a U.S. resident in Code section 7701, this exception to the saving clause is of less relevance, since time spent in the United States as a foreign government employee does not count in applying the physical presence test of residence.)

This article applies only to remuneration and pensions paid in respect of services of a governmental nature. Paragraph 3 provides that remuneration and pensions paid in respect of services for a government-conducted business (for example, a government-operated airline) are covered by Articles 14 (Independent Personal Services), 15 (Dependent Personal Services) or 19 (Pensions), as appropriate.

Article 19. PENSIONS

Except as provided in Article 18 (Government Service), pensions and similar remuneration in consideration of past employment may be taxed only by the Contracting State of which the beneficial owner is a resident. It is understood that the services need not have been performed by the beneficial owner of the pension; for example, a pension paid to a surviving spouse who is a resident of Ukraine would be exempt from tax by the United States on the same basis as if the right to the pension had been earned directly by the surviving spouse. A pension may be paid in installments or in a lump sum.

Social security benefits and other public pensions paid by a Contracting State, other than in consideration of past employment, may be taxed only by that State. This rule is also an exception to the saving clause of paragraph 3 of Article 1 (General Scope). Thus, a Ukrainian social security benefit will be exempt from U.S. tax even if the beneficiary is a U.S. resident or a U.S. citizen (whether resident in the United States, Ukraine, or a third country).

Since annuities, alimony and child support are not dealt with in this article or elsewhere in the Convention, they are taxable under Article 21 (Other Income). Under that Article

these items of income are taxable exclusively in the State of residence.

Article 20. STUDENTS, TRAINEES AND RESEARCHERS

This Article deals with visiting students, trainees, and, researchers. An individual who is a resident of one of the Contracting States and who visits the other Contracting State for the primary purpose of studying at an accredited educational institution, such as a university, or of studying or doing research as the recipient of a grant or similar payment from a charitable organization, or of acquiring training for a profession, will not be taxed by that other State on amounts received from abroad to cover his expenses and on any grant or similar payment regardless of its source.

The reference to "primary purpose" is meant to describe individuals participating in a full-time program of study, training, or research. It was substituted for the reference in the OECD Model to "exclusive purpose" to prevent too narrow an interpretation; it is not the intention to exclude full-time students who, in accordance with their visas, may hold part-time employment jobs. For U.S. purposes, a religious, charitable etc. organization as described in paragraph 1(c) means an organization that qualifies as tax-exempt under section 501(c)(3).

The exemptions provided in paragraph 1 are available for the period of time ordinarily necessary to complete the study, training, or research but not for more than five years in the case of training or research. It is expected that in most cases study programs would also be completed within five years; however, an individual who completes both undergraduate and graduate degrees could require a longer period.

For the exemption to apply to a researcher, the research must be undertaken in the public interest, and not primarily for the private benefit of a specific person or persons. For example, the exemption would not apply to a grant from a tax-exempt research organization to search for the cure to a disease if the results of the research become the property of a for-profit company. The exemption would not be denied, however, if the tax-exempt organization licensed the results of the research to a for-profit enterprise in consideration of an arm's-length royalty consistent with its tax-exempt status.

This Article is an exception to the saving clause of paragraph 3 of Article 1 (General Scope). Thus, a Ukrainian student, trainee, or researcher is entitled to the benefits of this Article even if such individual becomes a resident of the United States under the substantial presence test of Code section 7701(b). However, the benefits of this Article are not available to a U.S. citizen or green card holder.

Unlike the 1973 Convention, the Convention does not provide any special benefits for teachers. Pursuant to Article 29 (Entry into Force), the benefits provided by the 1973 Convention may be claimed for the first taxable year after the entry into force of the Convention, but in that case none of the benefits of the new Convention may be claimed during that year.

Article 21. OTHER INCOME

This Article provides the rules for the taxation of items of income not dealt with in the other articles of the Convention, such as alimony, child support payments, lottery winnings, punitive damages, and cancellation of indebtedness income.

Paragraph 1 contains the general rule that items of income derived by a resident of a Contracting State and not dealt with elsewhere in the Convention may be taxed only in the State of residence. This exclusive right of taxation applies irrespective of the source of the income.

Paragraph 2 contains an exception to the general rule of paragraph 1 for income that is attributable to a permanent establishment or fixed base that is or was maintained in a Contracting State by a resident of the other Contracting State. The taxation of such income is governed by the provisions of Articles 7 (Business Profits) or 14 (Independent Personal Services). For example, other income, wherever arising, that is attributable to a permanent establishment that is or was maintained in the United States by a resident of Ukraine would be taxable by the United States.

Article 22. LIMITATION ON BENEFITS

Article 22 addresses the problem of "treaty shopping" by limiting source basis tax benefits granted by a Contracting State pursuant to the Convention to those residents of the other Contracting State that have a substantial business nexus with, or otherwise have a significant business purpose for residing in, the other Contracting State. For example, a resident of a third State might establish an entity resident in a Contracting State for the purpose of deriving income from the other Contracting State and claiming source State benefits with respect to that income. Article 22 limits the abuse of the Convention by limiting the benefits of the Convention to those persons whose residence in a Contracting State has not been motivated by the existence of the Convention. Absent Article 22, the entity would generally be entitled to benefits as a resident of a Contracting State, although the entity might be denied those benefits as a result of limitations imposed by the domestic law of the source State, (e.g., business purpose, substance-over-form, step transaction or conduit principles). Article 22 and the anti-abuse provisions of domestic law complement each other, as

Article 22 generally determines whether an entity has a sufficient nexus to the Contracting State to be treated as a resident for treaty purposes, while domestic anti-abuse provisions determine whether a particular transaction should be recast in accordance with its substance.

Article 22 follows the form used in other recent U.S. income tax treaties. See, e.g., the Convention between the United State of America and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes. 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 Convention in the other Contracting State. Paragraph 2 provides that benefits also may be granted to a person not entitled to benefits under the tests of paragraph 1, if the competent authority of the source State determines that it is appropriate to provide benefits in that case. Paragraph 3 defines the term "gross income" as used in paragraph 1(e)(ii). Point 6 of the Protocol defines the term "officially recognized securities exchange" as used in paragraph 1(c) as that term applies to the United States. At the time the Convention was signed there was not yet a corresponding definition for the Ukrainian securities exchange, which was then being developed.

The first category of persons eligible for benefits from the other Contracting State under paragraph 1 consists of individual residents of a Contracting State. It is unlikely that individuals can be used to derive treaty-benefitted income on behalf of a third-country resident. If such an individual is receiving income as a nominee on behalf of a third country resident, benefits will be denied under the respective articles of the Convention by the requirement that the beneficial owner of the income be a resident of a Contracting State.

The second category consists of active businesses that are residents of one of the Contracting States and derive income from the other Contracting State that is connected with, or incidental to, that business. For this purpose, the business of making or managing investments is not considered an active business unless carried on by a bank or insurance company. The first six examples in the Memorandum of Understanding regarding the scope of the Limitations on Benefits Article in the Convention Between the Federal Republic of Germany and the United States of America (German Convention) illustrate the situations covered by subparagraph (b).

The third category consists of companies whose shares are regularly traded in substantial volume on an officially recognized securities exchange, or a company wholly owned, directly or indirectly, by a company that is a resident of the

same State and whose shares are so traded.

The fourth category covers tax exempt organizations, if more than half of the beneficiaries, members, or participants, if any, are individual residents of either Contracting State or persons who meet the criteria of subparagraphs (a), (b), (c), or (e) of this Article.

The fifth category provides a two part test, the so-called ownership and base erosion tests. Both must be satisfied for the resident to be entitled to benefits under subparagraph (e). The ownership test requires that 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) be owned, directly or indirectly, by persons who are themselves entitled to benefits under the other tests of paragraph 1 (other than subparagraph (b)). The base erosion test requires that not more than 50 percent of the person's gross income be used, directly or indirectly, to meet liabilities to persons other than persons eligible for benefits under the other tests of paragraph 1 (other than subparagraph (b)). For this purpose "gross income" means gross receipts or, in the case of a manufacturing or producing activity, gross receipts less the direct costs of labor and materials.

The rationale for this two-part test is that, to prevent such benefits from inuring substantially to third-country residents, it is not sufficient to require substantial ownership of the equity of the entity by treaty country residents. It is also necessary to ensure that the entity's tax base not be eroded by deductible payments to third country residents.

It is intended that the provisions of paragraph 1 will be self executing. Unlike the provisions of paragraph 2, discussed below, claiming benefits under paragraph 1 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 paragraph and is not entitled to the benefits claimed.

It is understood that, just as the two Contracting States and their political subdivisions are to be treated as residents of those States for purposes of Convention benefits, they also are entitled to benefits under Article 22.

Paragraph 2 permits the competent authority of the State in which income arises to grant Convention benefits in additional cases, even if the beneficial owner of the income does not meet the safe harbor standards of paragraph 1 (or the information is not available to make such a determination). This discretionary provision is included in recognition that, with the increasing scope and diversity of international economic relations, there

may be cases where significant participation by third country residents in an enterprise of a Contracting State is warranted by sound business practice and does not indicate a motive of attempting to derive unintended Convention benefits.

Article 23. PROPERTY

This Article specifies the circumstances in which a Contracting State may impose tax on property owned by a resident of the other Contracting State. Since neither the United States nor Ukraine imposes a national-level tax on capital, the purpose of this article is to provide rules to deal with any such tax subsequently enacted.

Paragraph 1 provides that real property (as defined in Article 6 (Income from Real Property)) that is owned by a resident of one Contracting State but located in the other Contracting State may be taxed by that other State.

Paragraph 2 provides the same rule for movable property that is part of the business property of a permanent establishment or fixed base that a resident of one Contracting State maintains in the other Contracting State. Such capital may be taxed in that other State.

In both cases, paragraphs 1 and 2, the State of residence may also tax; the taxing right given to the State where the capital is located is not an exclusive right.

Paragraph 3 provides that ships, aircraft or containers owned by a resident of one Contracting State and operated in international traffic may be taxed only in the residence State. This is consistent with the rule of Article 8 (Shipping and Air Transport), that addresses the income from international transportation activities.

Paragraph 4 provides the same rule as paragraph 3, taxation only in the country of residence of the owner, for all other items of property.

Article 24. RELIEF FROM DOUBLE TAXATION

Each Contracting State uses the foreign tax credit method to avoid double taxation of income arising in the other State. The credit is subject to the limitations of domestic law, such as Code sections 56(a) and 904.

Paragraph 7 of the Protocol explains and modifies this Article. Subparagraph (a) of paragraph 7 of the Protocol modifies the Ukrainian taxes described in Article 2 (Taxes Covered), i.e., the tax on income (profits) of enterprises, the income tax on individuals, and any substantially similar tax that

is subsequently introduced. The modified taxes constitute separate levies (*i.e.*, are considered to be distinct from the Ukrainian statutory taxes) for purposes of determining their eligibility for the credit allowed under section 901. The Protocol's modifications (described below) are intended to make such levies conform to taxes on net income that would satisfy the U.S. standards of a creditable foreign income tax.

At the time the Convention was signed, the base on which the Ukrainian taxes covered in Article 2 were imposed was determined without a full deduction for labor costs and interest expense in the case of companies with Ukrainian participation (either wholly owned by Ukrainian residents or joint ventures with Ukrainian participation). The Protocol's modifications remove this obstacle to creditability of the Ukrainian tax for the persons described in the Protocol. Based on these modifications, the Protocol provides that the Ukrainian taxes described in Article 2, as modified by this Convention and in effect on the date of signature of the Convention (March 4, 1994), are income taxes for purposes of Article 24 (Relief from Double Taxation), and therefore are fully creditable for U.S. income tax purposes. This provision has no effect on the creditability of Ukrainian taxes imposed on persons other than those described in the Protocol; the creditability of taxes imposed on such persons would be determined under the general principles of U.S. law.

Subparagraph (a) of paragraph 7 of the Protocol permits full deductions for wages and interest expense of a joint venture that is a resident of Ukraine when U.S. residents own at least 20 percent of the beneficial interest in the venture and the venture's total corporate capital (*i.e.*, equity capital owned by all participants determined without regard to country of residence) amounts to at least \$100,000 (an "eligible U.S. venture"). An eligible U.S. venture may deduct its expenses for remuneration for personal services in determining its Ukrainian tax base. Subparagraph (a) also applies to a permanent establishment in Ukraine of a United States resident, and to an individual who is a U.S. citizen or resident and who carries on activities in Ukraine as an entrepreneur (*i.e.*, a sole proprietorship or self-employed service provider). This provision does not alter the general rule under Article 7 (Business Profits) that deductions will not be allowed for interest paid by a permanent establishment to the home office. Consequently, in accordance with Article 7 (Business Profits), a permanent establishment will be allowed deductions for interest expenses only to the extent they are reasonably allocable to the permanent establishment.

Subparagraph (b) of paragraph 7 of the Protocol provides that the 20 percent beneficial U.S. ownership requirement of subparagraph 7(a) of the Protocol for eligible U.S. ventures may be satisfied by indirect ownership through residents of the

United States or Ukraine. Thus, for example, a Ukrainian company that is wholly-owned by another Ukrainian company would be an eligible U.S. venture if at least 20 percent of the second Ukrainian company were owned by a U.S. resident. If, however, the second Ukrainian company were a resident of a third state, the U.S. ownership of that second company would not be considered for purposes of subparagraph 7(a).

Subparagraph (c) ensures that the U.S. recipient of Ukrainian source dividends and royalties can claim a U.S. foreign tax credit with respect to the Ukrainian withholding taxes imposed on such income. Under Ukrainian law, the payor of dividends and royalties is considered to be liable for the withholding tax, rather than the recipient as under U.S. law. Subparagraph (c) provides that for U.S. tax purposes the recipient will be deemed to be liable for the tax, if the recipient elects to include the tax in gross income, thereby ensuring that the Ukrainian tax may be claimed as a credit against U.S. liability.

Finally, subparagraph (d) provides that no tax sparing credits will be provided. If the United States permits such a credit in the future, whether through an amendment of its internal law or through a treaty with a third State, it is agreed that the Convention will be amended to authorize the provision of such credits. Such an amendment to the Convention would be subject to constitutionally required ratification procedures in each State. The United States has undertaken a similar obligation with respect to the income tax convention with India.

25. NON-DISCRIMINATION

This Article ensures that citizens 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.

Paragraph 1 provides that a citizen of one Contracting State may not be subject to taxation or connected requirements in the other Contracting State that are different from or more burdensome than the taxes and connected requirements imposed upon a citizen of that other State or of a third State in the same circumstances. A citizen of a Contracting State is afforded protection under this paragraph even if the citizen 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 tax treatment in Ukraine as a citizen of any other country who is a resident of that third country and in the same circumstances.

It is understood, however, that for U.S. tax purposes, a U.S. citizen who is resident outside the United States, whether

in Ukraine or a third country, is not in the same circumstances as a citizen of Ukraine who is a resident outside the United States, because the U.S. citizen is subject to U.S. tax on his worldwide income and the Ukrainian citizen is subject to U.S. tax on only his U.S. income. Thus, a citizen of Ukraine resident in a third state is not entitled under this Article to net-basis taxation at source of dividends paid by U.S. companies because a U.S. citizen resident in a third country is taxed on a net basis by the United States. Similarly, it is understood that neither Contracting State is required to grant to residents of the other Contracting State the same personal exemptions and deductions that it provides to its own residents to take account of marital status or family responsibilities.

Paragraph 2 of the Article provides that a permanent establishment in a Contracting State of a resident of the other Contracting State may not be less favorably taxed in the first-mentioned State than an enterprise of that first-mentioned State or of a third State which is carrying on the same activities.

Section 1446 of the Code imposes on any partnership, whether domestic or foreign, the obligation to withhold tax from a foreign partner's distributive share of income effectively connected with a U.S. trade or business. If tax has been over-withheld, the partner can, as in other cases of over-withholding, file for a refund. In the context of the Convention, this obligation applies with respect to a Ukrainian 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 that this withholding provision is not a form of discrimination within the meaning of paragraph 2 of the Article, but merely a reasonable adaptation of the mode of taxation to the particular circumstances of nonresident partners. Like other withholding provisions applicable to nonresident aliens, this is 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.

Paragraphs 3 and 4 prevent discrimination against residents of a Contracting State who engage in business transactions with residents of the other Contracting State. Paragraph 3 prohibits discrimination in the allowance of deductions. When a resident of a Contracting State pays interest or royalties or makes 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 State. An exception to this rule is provided for cases where the provisions of paragraph 1 of

Article 9 (Associated Enterprises), paragraph 4 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 to excess (not at arm's length) payments between related persons. Accordingly, paragraph 3 permits the denial or deferral of a deduction for interest in accordance with domestic thin capitalization rules such as section 163(j). 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 a resident of a Contracting State to a resident of the other Contracting State are deductible in the first-mentioned Contracting State in computing taxable capital under the same conditions as if the debt had been contracted to a resident of the first-mentioned State. Thus, for example, if a tax is imposed on the value of real property net of debt, the same deduction must be allowed with respect to debt of creditors who are residents of either Contracting State. In this case, the Article would also apply to a real property tax imposed by a local government.

Paragraph 4 requires that a Contracting State not impose other or more burdensome taxation or connected requirements on a company that is a resident of that State that 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 that it imposes on similar resident companies owned by residents of the first-mentioned State or of a third State. It is understood that the U.S. rules that impose tax on a liquidating distribution of a U.S. subsidiary of a Ukrainian company and the rule restricting the use of small business corporations to U.S. citizens and resident alien shareholders do not violate the provisions of this Article.

Paragraph 5 of the Article specifies that no provision of the Article will prevent either Contracting State from imposing the branch profits tax described in paragraph 5 of Article 10 (Dividends). At present Ukraine does not impose such a tax, but if it were to introduce one consistent with paragraph 5 of Article 10 it could do so under this Article.

Paragraph 6 provides that the provisions of this Article do not extend to benefits granted to citizens or residents of a third State in accordance with a special agreement with that third State, such as an income tax Convention.

Paragraph 7 provides that, notwithstanding the specification of taxes covered by the Convention in Article 2 (Taxes Covered), for purposes of providing nondiscrimination protection this

Article applies to taxes of every kind and description imposed by a Contracting State or a political subdivision. Customs duties are not considered to be taxes for this purpose.

The saving clause of paragraph 3 of Article 1 (General Scope) does not apply to this Article, by virtue of the exceptions in paragraph 4(a) of Article 1. Thus, for example, a U.S. citizen who is resident in Ukraine may claim benefits in the United States under this Article.

Article 26. MUTUAL AGREEMENT PROCEDURE

This Article provides for cooperation between the competent authorities of the Contracting States to resolve disputes that may arise under the Convention and to resolve cases of double taxation not provided for in the Convention.

Paragraph 1 provides that, where a person considers that the actions of one or both Contracting States will result for him in taxation that is not in accordance with the Convention, he may present his case to the competent authority of his State of residence or citizenship. It is not necessary for a person first to have exhausted the remedies provided under the national laws of the Contracting States before presenting a case to the competent authorities. The Convention does not limit the time during which a case may be brought.

Paragraph 2 provides that, if the competent authority of the Contracting State to which the case is presented considers the case to have merit, and if it cannot reach a unilateral solution, it will seek agreement with the competent authority of the other Contracting State to avoid taxation not in accordance with the Convention. If agreement is reached under this provision, it is to be implemented even if implementation would be otherwise barred by the statute of limitations or by some other procedural limitation, such as a closing agreement. Because, as specified in paragraph 2 of Article 1 (General Scope), the Convention cannot operate to increase a taxpayer's liability, the Convention overrides time or other procedural limitations of domestic law only for the purpose of making refunds (not to impose additional tax).

Paragraph 3 authorizes the competent authorities to seek to resolve difficulties or doubts that may arise as to the application or interpretation of the Convention. The paragraph includes a non-exhaustive list of examples of the kinds of matters about which the competent authorities may reach agreement. They may agree to the same attribution of income, deductions, credits or allowances between a resident of one Contracting State and its permanent establishment in the other, and to the allocation of income, deductions, credits or allowances between persons. These allocations are to be made in

accordance with the arm's length principles of Article 7 (Business Profits) and Article 9 (Associated Enterprises). The competent authorities may also agree to settle a variety of conflicting applications of the Convention, including those regarding the characterization of items of income, the application of source rules to particular items of income, and differences in meanings of a term. Agreements reached by the competent authorities under this paragraph need not conform to the internal law provisions of either Contracting State. The competent authorities also may address cases of double taxation not foreseen by the Convention and attempt to reach an agreement that would prevent that result.

Paragraph 4 authorizes the competent authorities to communicate with each other directly for these purposes. It is not necessary to communicate through diplomatic channels.

The benefits of this Article are also available to residents of either Contracting State. (See paragraph 4(a) of Article 1 (General Scope).)

Article 27. EXCHANGE OF INFORMATION

This Article provides for the exchange of information between the competent authorities of the Contracting States. The information to be exchanged is that necessary for carrying out the provisions of the Convention or the domestic laws of the United States or Ukraine concerning the taxes covered by the Convention. For the purposes of this Article, the taxes covered by the Convention include all taxes imposed at the national level. Exchange of information with respect to domestic law is authorized insofar as the taxation under those domestic laws is not contrary to the Convention. Thus, for example, information may be exchanged with respect to any national level tax, even if the transaction to which the information relates is a purely domestic transaction in the requesting State.

Paragraph 1 states that information exchange is not restricted by Article 1 (General Scope). This means that information may be requested and provided under this Article with respect to persons who are not residents of either Contracting State. For example, if a third-country resident has a permanent establishment in Ukraine that engages in transactions with a U.S. resident, the United States could request information with respect to that permanent establishment, even though it is not a resident of either Contracting State. Such information would not be routinely exchanged, but may be requested in specific cases.

Paragraph 1 also provides assurances that any information received in accordance with this Article will be treated as secret, subject to the same restrictions on disclosure that apply to information obtained under the laws of the requesting State.

Information received may be disclosed only to persons, including courts and administrative bodies, concerned with the assessment, collection, enforcement or prosecution in respect of the taxes to which the information relates, or to persons concerned with the administration of these taxes. The information must be used by such persons in connection with these designated functions. Persons concerned with the administration of taxes, in the United States, include the tax-writing committees of Congress and the General Accounting Office. Information received by these bodies is for use in the performance of their role in overseeing the administration of U.S. tax laws. Information received under this Article may be disclosed in public court proceedings or in judicial decisions.

Paragraph 2 explains that the obligations undertaken in paragraph 1 to exchange information do not require a Contracting State to carry out administrative measures that are at variance with the laws or administrative practice of either State. Nor is either State obligated to supply information not obtainable under the laws or administrative practice of either State. Thus, there is no obligation to furnish information to the other Contracting State if either the requested State or the requesting State could not obtain such information for itself in a domestic case. There is also no obligation to disclose trade secrets or other information, the disclosure of which would be contrary to public policy. Either Contracting State may, however, at its discretion, subject to the limitations of the paragraph and its internal law, provide information that it is not obligated to provide under the provisions of this paragraph.

Paragraph 3 provides that, when information is requested by a Contracting State in accordance with this Article, the other Contracting State is obligated to obtain the requested information as if the tax in question were the tax of the requested State, even if that State has no direct tax interest in the case to which the request relates. The paragraph further provides that the requesting State may specify the form in which information is to be provided (e.g., depositions of witnesses and authenticated copies of original documents), so that the information can be used in the judicial proceedings of the requesting State. The requested State should provide the information in the form requested to the same extent that it can obtain information in that form under its own laws and administrative practices with respect to its own taxes.

Paragraph 4 provides that this Article applies to taxes of every kind and description, irrespective of whether they are described in Article 2 (Taxes Covered).

Article 28. DIPLOMATIC AGENTS AND CONSULAR OFFICERS

This Article confirms that any fiscal privileges to which

members of diplomatic or consular missions are entitled under the general provisions of international law or under special agreements will apply, notwithstanding any provisions of this Convention. This Article protects the fiscal privileges of technical staff and other employees of such missions as well as those with diplomatic status.

Article 29. ENTRY INTO FORCE

This Article provides the rules for bringing the Convention into force and giving effect to its provisions. Paragraph 1 provides for the ratification of the Convention by both Contracting States and the prompt exchange of instruments of ratification at Kiev.

Paragraph 2 provides that the Convention will enter into force on the date on which instruments of ratification are exchanged. The Convention will have effect with respect to taxes withheld at source on dividends, interest and royalties for amounts paid or credited on or after the first day of the second month following the month in which the Convention enters into force. For example, if the Convention were to enter into force on July 10, 1994, the withholding rates on dividends, interest and royalties would be reduced (or eliminated) for amounts paid on or after August 1, 1995. For all other income taxes, the Convention will have effect for any taxable period beginning on or after January 1 of the year following entry into force.

The 1973 Convention will cease to have effect when the provisions of this Convention take effect in accordance with paragraph 2.

Paragraph 4 provides that a person entitled to the benefits of the 1973 Convention may elect to continue to apply that Convention for the first taxable year in which this Convention would otherwise have effect. This is a taxpayer-by-taxpayer election, *i.e.*, a taxpayer may not elect the 1973 Convention for one purpose and the Convention for another purpose.

Article 30. TERMINATION

The Convention is to remain in effect indefinitely, unless terminated by one of the Contracting States in accordance with the provisions of this Article. A Contracting State may terminate the Convention at any time after 5 years from the date of its entry into force by giving written notice through diplomatic channels to the other Contracting State at least six months in advance. If such notice is given, the Convention will cease to apply in respect of taxes withheld on dividends, interest and royalties paid or credited on or after the first of January following the six month period and with respect to other taxes for taxable periods beginning on or after the first of

January following the six month period. Thus, for example, if notice of termination is given in July or later of a calendar year, the termination will not be effective as of the following January 1 but as of the second January 1, since the notice period must continue for at least six months.

Article 30 relates to unilateral termination by a Contracting State of the Convention. The Article does not prevent the Contracting States from entering into a new bilateral agreement that supersedes, amends or terminates provisions of the Convention either prior to the expiration of the five year period or without the six month notification period.