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PROTOCOL AMENDING THE  
TAX CONVENTION WITH JAPAN

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JULY 8, 2019.—Ordered to be printed

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Mr. RISCH, from the Committee on Foreign Relations,  
submitted the following

REPORT

[To accompany Treaty Doc. 114–1]

The Committee on Foreign Relations, to which was referred the Protocol Amending the Convention between the United States of America and the Government of Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and a related agreement entered into by an exchange of notes (together with the “proposed Protocol”), both signed on January 24, 2013, at Washington, together with correcting notes exchanged March 9 and March 29, 2013 (Treaty Doc. 114–1), having considered the same, reports favorably thereon with a declaration and conditions, as indicated in the resolution of advice and consent, and recommends that the Senate give its advice and consent to ratification thereof, as set forth in this report and the accompanying resolution of advice and consent.

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I. PURPOSE

The purpose of the Protocol, along with the underlying treaty, is to promote and facilitate trade and investment between the United States and Japan. Many of the provisions in the proposed Protocol are intended to bring the existing Convention in closer conformity with the 2006 U.S. Model, accounting for particular aspects of Jap-

anese law and its interaction with U.S. laws. The proposed Protocol provides an exemption from source-country withholding tax on all cross-border payments of interest largely in conformity with the U.S. Model Treaty and expands the category of cross-border dividends that are eligible for an exemption from source-country withholding, including modifying the ownership requirement for exemption. The proposed Protocol would amend provisions of the existing Convention governing the taxation of capital gains to allow for taxation of gains from the sale of real property and real property interests by the State where such property is located in conformity with the Foreign Investment in Real Property Tax Act. The proposed Protocol also incorporates into the existing Convention provisions that allow the revenue authorities of a Convention party to request assistance on revenue collection from the other party.

The Protocol contains provisions to ensure the exchange of information between tax authorities in both countries, consistent with both the U.S. Model, international standards, and U.S. law.

## II. BACKGROUND

The United States has a tax treaty with Japan that is currently in force, which was concluded in 2003 (Convention between the Government of The United States Of America and the Government of Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, signed at Washington D.C. on 6 November, 2003). The proposed Protocol was negotiated to bring U.S.-Japan tax treaty relations into closer conformity with each country's current tax treaty policies. For example, the proposed Protocol also includes updated exchange of information articles and a mandatory binding arbitration provision to resolve disputes between the revenue authorities of the United States and Japan.

## III. MAJOR PROVISIONS

A detailed article-by-article analysis of the Protocol may be found in the Technical Explanation Published by the Department of the Treasury on April 13, 2015, which is included at Annex 1 to this report. In addition, the staff of the Joint Committee on Taxation prepared an analysis of the Protocol, JCX-136-15 (October 29, 2015), which was of great assistance to the committee in reviewing the Protocol. A summary of the key provisions of the Protocol is set forth below.

### ASSISTANCE IN COLLECTION OF TAXES

The proposed Protocol incorporates into the existing Convention provisions that enable a party's revenue authority to make a limited number of requests for assistance of the other party's revenue authority in the collection of taxes, related costs, interest, and penalties. Requests for assistance are also limited by certain conditions depending on whether the revenue claim is against a company or an individual.

### EXCHANGE OF INFORMATION

Consistent with the U.S. Model and international standards, the proposed Protocol provides authority for the two countries to ex-

change tax information that is foreseeably relevant to carrying out the provisions of the existing Convention as amended by the proposed Protocol. The proposed Protocol allows the United States to obtain information (including from financial institutions) from Japan regardless of whether Japan needs the information for its own tax purposes.

#### MANDATORY ARBITRATION

The Protocol incorporates mandatory, binding arbitration for certain cases where the competent authorities of the United States and Japan have been unable to resolve after a reasonable period of time. A mandatory and binding arbitration procedure was not included in the 2006 U.S. Model treaty, but has recently been included in the U.S. income tax treaties with Belgium, Canada, Germany, France, Switzerland, and Spain.

#### IV. ENTRY INTO FORCE

The proposed Protocol shall enter into force upon exchange of instruments of ratification. The proposed Protocol will have effect, with respect to taxes withheld at source, for amounts paid or credited on or after the first day of the third month next following the date of entry into force of the proposed Protocol, and with respect to other taxes, for taxable years beginning on or after the first day of January next following the date of entry into force of the proposed Protocol. Special rules apply for the entry into force of the mandatory binding arbitration provisions.

#### V. IMPLEMENTING LEGISLATION

As is the case generally with income tax treaties, the Protocol is self-executing and does not require implementing legislation for the United States.

#### VI. COMMITTEE ACTION

The committee held a public hearing on the Protocol in the 114th Congress. The transcript for the committee hearing held in the 114th Congress on October 29, 2015 can be found in Annex 2, pages 23–69, in Exec. Rept. 114–1. The committee heard testimony from Robert B. Stack, Deputy Assistant Secretary for International Tax Affairs at the Department of the Treasury, Washington, D.C., and from Thomas A. Barthold, Chief of Staff, Joint Committee on Taxation, Washington, D.C. The committee considered the Protocol and reported it favorably in the 114th Congress on November 10, 2015.

In the 116th Congress, the committee hosted a staff briefing from Department of the Treasury and Department of State officials with Senate Foreign Relations, Finance and Joint Tax Committee staff on June 11, 2019. On June 25, 2019, the committee considered the Protocol and ordered it favorably reported, with a quorum present and without objection.

#### VII. COMMITTEE COMMENTS

The Committee on Foreign Relations believes that the Protocol will stimulate increased trade and investment, reduce tax evasion,

and promote closer co-operation between the United States and Japan. The committee therefore urges the Senate to act promptly to give advice and consent to ratification of the Protocol, as set forth in this report and the accompanying resolution of advice and consent.

#### A. INFORMATION EXCHANGE

The Protocol would replace the existing Convention's tax information exchange provisions with updated rules that are consistent with current U.S. tax treaty practice. The provision would allow the tax authorities of each country to exchange information relevant to carrying out the provisions of the Convention or the domestic tax laws of either country. It would also enable the United States to obtain information (including from financial institutions) from Japan whether or not Japan needs the information for its own tax purposes.

After careful examination of this Protocol, as well as witness testimony and responses to questions for the record (from the hearing held on October 29, 2015, as referenced in part "VI Committee Action" of this report), the committee believes that the exchange of information provisions will substantially aid in the full and fair enforcement of United States tax laws. According to witness testimony, the "foreseeably relevant" standard used in the Protocol does not represent a lower threshold than the standard found in earlier U.S. tax treaties. Witnesses also testified that the "foreseeably relevant" standard has been extensively defined in internationally agreed guidance. The committee is also of the view that the Protocol provides adequate provisions to ensure that any information exchanged pursuant to the Convention is treated confidentially. In particular, the Committee notes the provisions under new Article 26 as proposed by the Protocol, that require information received under an information request by a Party be treated as secret and disclosed only to persons or authorities involved in the administration and enforcement of the tax laws and be used only for such purposes. In sum, the committee believes these provisions on information exchange are important to the administration of U.S. tax laws and the Protocol provides adequate protection against the misuse of information exchanged pursuant to the Convention.

#### B. DECLARATION ON THE SELF-EXECUTING NATURE OF THE CONVENTION

The committee has included one declaration in the recommended resolution of advice and consent. The declaration states that the Convention is self-executing, as is the case generally with income tax treaties. Prior to the 110th Congress, the committee generally included such statements in the committee's report, but in light of the Supreme Court decision in *Medellin v. Texas* 128 S. Ct. 1346 (2008), the committee determined that a clear statement in the Resolution is warranted. A further discussion of the committee's views on this matter can be found in Section VIII of Executive Report 110-12.

VIII. TEXT OF RESOLUTION OF ADVICE AND  
CONSENT TO RATIFICATION

*Resolved (two-thirds of the Senators present concurring therein),*

**SECTION 1. SENATE ADVICE AND CONSENT SUBJECT TO A DECLARATION**

The Senate advises and consents to the ratification of the Protocol Amending the Convention between the United States of America and the Government of Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and a related agreement entered into by an exchange of notes, both signed at Washington on January 24, 2013, as corrected by an exchange of notes on March 9 and 29, 2013 (the "Protocol") (Treaty Doc. 114–1), subject to the declaration of section 2 and the conditions of section 3.

**SECTION 2. DECLARATION**

The advice and consent of the Senate under section 1 is subject to the following declaration:

The Convention is self-executing.

**SECTION 3. CONDITIONS**

The advice and consent of the Senate under section 1 is subject to the following conditions:

(1) Not later than 2 years after the Protocol enters into force and prior to the first arbitration conducted pursuant to the binding arbitration mechanism provided for in the Protocol, the Secretary of the Treasury shall transmit to the Committees on Finance and Foreign Relations of the Senate and the Joint Committee on Taxation the text of the rules of procedure applicable to arbitration panels, including conflict of interest rules to be applied to members of the arbitration panel.

(2)(A) Not later than 60 days after a determination has been reached by an arbitration panel in the tenth arbitration proceeding conducted pursuant to the Protocol or any of the treaties described in subparagraph (B), the Secretary of the Treasury shall prepare and submit to the Joint Committee on Taxation and the Committee on Finance of the Senate, subject to laws relating to taxpayer confidentiality, a detailed report regarding the operation and application of the arbitration mechanism contained in the Protocol and such treaties. The report shall include the following information:

(i) For the Protocol and each such treaty, the aggregate number of cases pending on the respective dates of entry into force of the Protocol and each treaty, including the following information:

(I) The number of such cases by treaty article or articles at issue.

(II) The number of such cases that have been resolved by the competent authorities through a mutual agreement as of the date of the report.

(III) The number of such cases for which arbitration proceedings have commenced as of the date of the report.

(ii) A list of every case presented to the competent authorities after the entry into force of the Protocol and each

such treaty, including the following information regarding each case:

(I) The commencement date of the case for purposes of determining when arbitration is available.

(II) Whether the adjustment triggering the case, if any, was made by the United States or the relevant treaty partner.

(III) Which treaty the case relates to.

(IV) The treaty article or articles at issue in the case.

(V) The date the case was resolved by the competent authorities through a mutual agreement, if so resolved.

(VI) The date on which an arbitration proceeding commenced, if an arbitration proceeding commenced.

(VII) The date on which a determination was reached by the arbitration panel, if a determination was reached, and an indication as to whether the panel found in favor of the United States or the relevant treaty partner.

(iii) With respect to each dispute submitted to arbitration and for which a determination was reached by the arbitration panel pursuant to the Protocol or any such treaty, the following information:

(I) In the case of a dispute submitted under the Protocol, an indication as to whether the presenter of the case to the competent authority of a Contracting State submitted a Position Paper for consideration by the arbitration panel.

(II) An indication as to whether the determination of the arbitration panel was accepted by each concerned person.

(III) The amount of income, expense, or taxation at issue in the case as determined by reference to the filings that were sufficient to set the commencement date of the case for purposes of determining when arbitration is available.

(IV) The proposed resolutions (income, expense, or taxation) submitted by each competent authority to the arbitration panel.

(B) The treaties referred to in subparagraph (A) are—

(i) the 2006 Protocol Amending the Convention between the United States 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, done at Berlin June 1, 2006 (Treaty Doc. 109–20) (the “2006 German Protocol”);

(ii) the Convention between the Government of the United States of America and the Government of the Kingdom of Belgium for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, and accompanying protocol, done at Brussels July 9, 1970 (the “Belgium Convention”) (Treaty Doc. 110–3);

(iii) the Protocol Amending the Convention between the United States of America and Canada with Respect to Taxes on Income and on Capital, signed at Washington September 26, 1980 (the “2007 Canada Protocol”) (Treaty Doc. 110–15); or

(iv) the Protocol Amending the Convention between the Government of the United States of America and the Government of the French Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, signed at Paris August 31, 1994 (the “2009 France Protocol”) (Treaty Doc. 111–4).

(3) The Secretary of the Treasury shall prepare and submit the detailed report required under paragraph (2) on March 1 of the year following the year in which the first report is submitted to the Joint Committee on Taxation and the Committee on Finance of the Senate, and on an annual basis thereafter for a period of five years. In each such report, disputes that were resolved, either by a mutual agreement between the relevant competent authorities or by a determination of an arbitration panel, and noted as such in prior reports may be omitted.

(4) The reporting requirements referred to in paragraphs (2) and (3) supersede the reporting requirements contained in paragraphs (2) and (3) of section 3 of the resolution of advice and consent to ratification of the 2009 France Protocol, approved by the Senate on December 3, 2009.

## IX. ANNEX 1.—TECHNICAL EXPLANATION

DEPARTMENT OF THE TREASURY TECHNICAL EXPLANATION OF THE PROTOCOL SIGNED AT WASHINGTON ON JANUARY 14, 2013 AMENDING THE CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF JAPAN FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME AND THE PROTOCOL, WHICH FORMS AN INTEGRAL PART OF THE CONVENTION, SIGNED AT WASHINGTON ON NOVEMBER 6, 2003

This is a Technical Explanation of the Protocol signed at Washington on January 24, 2013, and the related Exchange of Notes (hereinafter the “Protocol” and “Exchange of Notes” respectively), amending the Convention between the Government of the United States of America and the Government of Japan for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed at Washington on November 6, 2003 (hereinafter the “existing Convention”), the Protocol, which forms an integral part of the existing Convention, signed at Washington on November 6, 2003 (hereinafter the “Protocol of 2003”), and the agreement effectuated by an Exchange of Notes on November 6, 2003 (hereinafter the “Notes of 2003”). The existing Convention, as amended by the Protocol of 2003 and the Protocol, is referred to as “the Convention.”

Negotiations took into account the U.S. Department of the Treasury’s current tax treaty policy and the Treasury Department’s Model Income Tax Convention, published on November 15, 2006 (the “U.S. Model”). Negotiations also took into account the Model Tax Convention on Income and on Capital, published by the Organisation for Economic Cooperation and Development (the “OECD Model”), and recent tax treaties concluded by both countries.

This Technical Explanation is an official guide to the Protocol and Exchange of Notes. It explains policies behind particular provisions, as well as understandings reached during the negotiations with respect to the interpretation and application of the Protocol and the Exchange of Notes.

References to the existing Convention are intended to put various provisions of the Protocol into context. The Technical Explanation does not, however, provide a complete comparison between the provisions of the existing Convention and the amendments made by the Protocol and Exchange of Notes. The Technical Explanation is not intended to provide a complete guide to the existing Convention as amended by the Protocol and Exchange of Notes. To the extent that the existing Convention has not been amended by the Protocol and Exchange of Notes, the technical explanation of the existing Convention and the Protocol of 2003 remains the official explanation. References in this Technical Explanation to “he” or “his” should be read to mean “he or she” or “his or her.” References to the “Code” are to the Internal Revenue Code of 1986, as amended.<sup>2</sup>

## ARTICLE I

Article I of the Protocol revises paragraph 5 of Article 1 of the existing Convention by deleting references to Article 20 of the ex-



isting Convention, which has been deleted by Article VII of the Protocol.

#### ARTICLE II

Article II of the Protocol replaces paragraph 4 of Article 4 of the existing Convention. Revised paragraph 4 provides that if by reason of paragraph 1, a person other than an individual is a resident of both Contracting States, such dual resident may not claim any benefit accorded to residents of a Contracting State by the Convention. The person may, however, claim any benefits that are not limited to residents, such as those provided by paragraph 1 of Article 24. Thus, for example, pursuant to Article 24, a State cannot impose discriminatory taxation on a dual resident company. Regardless of the outcome under this paragraph, a dual resident company also may be treated as a resident of a Contracting State for purposes other than that of obtaining benefits under the Convention. For example, if a dual resident company pays a dividend to a resident of Japan, the U.S. paying agent would withhold on that dividend at the appropriate treaty rate (assuming the payee is otherwise entitled to treaty benefits) because reduced withholding is a benefit enjoyed by the resident of Japan, not by the dual resident company. The dual resident company that paid the dividend would, for this purpose, be treated as a resident of the United States under the Convention. In addition, information relating to dual resident companies can be exchanged under the Convention because, by its terms, Article 26 is not limited to residents of the Contracting States.

#### ARTICLE III

Article III of the Protocol amends Article 10 of the existing Convention. Article 10 sets forth rules for taxation of cross-border dividend payments.

##### *Paragraph 1*

Paragraph 1 makes two amendments to subparagraph 3(a) of Article 10 of the existing Convention, which sets forth the ownership and holding period requirements that companies must satisfy in order to qualify for an exemption from withholding on certain dividends. Pursuant to the existing Convention, in order to qualify for the exemption from dividend withholding, the company receiving the dividend is required to own, directly or indirectly through one or more residents of either Contracting State, more than 50 percent of the voting stock of the company paying the dividends for the period of twelve months ending on the date on which entitlement to the dividend is determined (additional requirements also apply, such as beneficial ownership and qualification of certain limitation on benefits provisions). Paragraph 1 replaces “more than 50 percent” with “at least 50 percent.” Accordingly, a company receiving a dividend and owning directly or indirectly through residents of either Contracting State, 50 percent or more of the company paying the dividend would become eligible for the exemption from withholding at source, assuming that all other requirements have been satisfied. In addition to modifying the required ownership threshold for entitlement to the exemption from dividend withholding, para-

graph 1 of Article III also shortens the twelve-month holding period requirement to six months.

*Paragraph 2*

Paragraph 2 of Article III amends paragraph 9 of Article 10 of the existing Convention. The amendments delete references to paragraph 2 of Article 13 of the existing Convention to conform to changes to that Article made in Article V of the Protocol.

ARTICLE IV

Article IV of the Protocol replaces Article 11 of the existing Convention. Article 11 sets forth rules for taxation of cross-border interest payments.

*Paragraph 1 of New Article 11*

Paragraph 1 of new Article 11 generally grants to the residence State the exclusive right to tax interest beneficially owned by its residents and arising in the other Contracting State.

The term “beneficial owner” is not defined in the Convention, and is, therefore, defined under the domestic law of the source State. The beneficial owner of the interest for purposes of Article 11 is the person to which the income is attributable under the laws of the source State. Thus, if interest arising in a Contracting State is received by a nominee or agent that is a resident of the other State on behalf of a person that is not a resident of that other State, the interest is not entitled to the benefits of Article 11. However, interest received by a nominee on behalf of a resident of that other State would be entitled to benefits. These limitations are confirmed by paragraph 9 of the OECD Commentary to Article 11.

Special rules apply to interest derived through fiscally transparent entities for purposes of determining the beneficial owner of the interest. In such cases, residence State principles shall be used to determine who derives the interest, to assure that the interest for which the source State grants benefits of the Convention will be taken into account for tax purposes by a resident of the residence State.

For example, assume that FCo, a company that is a resident of Japan, owns a 50 percent interest in FP, a partnership that is organized in Japan. FP receives interest arising in the United States. Japan views FP as fiscally transparent under its domestic law, and taxes FCo currently on its distributive share of the income of FP and determines the character and source of the income received through FP in the hands of FCo as if such income were realized directly by FCo. In this case, FCo is treated as deriving 50 percent of the interest received by FP that arises in the United States under paragraph 6 of Article 4 of the existing Convention. The same result would be reached even if the tax laws of the United States would treat FP differently (e.g., if FP were not treated as fiscally transparent in the United States), or if FP were organized in a third state, as long as FP were still treated as fiscally transparent under the laws of Japan.

While residence State principles control who is treated as deriving the interest, source State principles of beneficial ownership apply to determine whether the person who derives the interest, or another resident of the other Contracting State, is the beneficial

owner of the interest. If the person who derives the interest under paragraph 6 of Article 4 of the existing Convention would not be treated as a nominee, agent, custodian, conduit, etc. under the source State's principles for determining beneficial ownership, that person will be treated as the beneficial owner of the interest for purposes of the Convention. In the example above, FCo is required to satisfy the beneficial ownership principles of the United States with respect to the interest it derives. If under the beneficial ownership principles of the United States, FCo is found not to be the beneficial owner of the interest, FCo will not be entitled to the benefits of Article 11 with respect to such interest. If FCo is found to be a nominee, agent, custodian, or conduit for a person who is a resident of the other Contracting State, that person may be entitled to benefits with respect to the interest.

*Paragraph 2 of New Article 11*

Paragraph 2 of new Article 11 provides anti-abuse exceptions to the source-country exemption in paragraph 1 for two classes of interest payments.

The first class of interest dealt with in subparagraph 2(a) is so-called "contingent interest." Such interest is defined in subparagraph 2(a) as any interest arising in a Contracting State that is determined by reference to the receipts, sales, income, profits or other cash flow of the debtor or a related person, to any change in the value of any property of the debtor or a related person or to any dividend, partnership distribution or similar payment made by the debtor or a related person, or any other interest similar to such interest arising in a Contracting State. Any such interest may be taxed in that Contracting State according to the laws of that State. If the beneficial owner is a resident of the other Contracting State, however, the gross amount of the interest may be taxed at a rate not exceeding 10 percent. With respect to interest arising in the United States, subparagraph 2(a) refers to contingent interest of a type that does not qualify as portfolio interest under U.S. domestic law as defined in Code section 871(h)(4). The exceptions of section 871(h)(4)(c) will be applicable.

The second class of interest is dealt with in subparagraph 2(b). This exception is consistent with the policy of Code sections 860E(e) and 860G(b) that excess inclusions with respect to a real estate mortgage investment conduit (REMIC) should bear full U.S. tax in all cases. Without a full tax at source, foreign purchasers of residual interests would have a competitive advantage over U.S. purchasers at the time these interests are initially offered. Also, absent this rule, the U.S. fisc would suffer a revenue loss with respect to mortgages held in a REMIC because of opportunities for tax avoidance created by differences in the timing of taxable and economic income produced by these interests.

Subparagraph 2(b) of new Article 11 is analogous to subparagraph 2(c) of the U.S. Model, although the provision in new Article 11 is drafted to apply bilaterally. Thus, for example, paragraph 2(b) of new Article 11 does not refer to the long-term Federal rate used to determine the amount of an excess inclusion, but rather to "the return on comparable debt instruments as specified by the domestic law of that Contracting State." Nevertheless, for U.S. tax purposes, the withholding tax imposed "to the extent that the amount

of interest paid exceeds the return on comparable debt instruments as specified by the domestic law of that Contracting State” is the withholding tax that would be imposed upon an excess inclusion with respect to a residual interest in a REMIC under section 860G(b).

*Paragraph 3 of New Article 11*

Paragraph 3 of new Article 11 provides a source rule that is identical to the interest source rule in paragraph 7 of the existing Convention. Interest generally is considered to arise in a Contracting State when paid by a resident of that Contracting State. Special rules are provided where the interest is borne by a permanent establishment of the person paying the interest. In such a case, if the permanent establishment is situated in a Contracting State, then the interest shall be deemed to arise in that Contracting State; and if the permanent establishment is situated in a state other than one of the Contracting States, then the interest shall not be deemed to arise in either Contracting State. While interest borne by a permanent establishment that is situated in a state other than one of the Contracting States thus will not be eligible for the benefits of the Convention, it may be eligible for the benefits of the tax treaty, if any, between the state in which the permanent establishment is situated and the Contracting State of which the beneficial owner of the interest is a resident.

For purposes of paragraph 3 of new Article 11, interest is considered to be borne by a permanent establishment if it is allocable to the taxable income of that permanent establishment. If the actual amount of interest on the books of a U.S. branch of a resident of Japan exceeds the amount of interest allocated to the branch under Treas. Reg. section 1.882-5, the amount of such excess will not be considered U.S. source interest for purposes of this Article.

*Paragraph 4 of New Article 11*

Paragraph 4 of new Article 11 provides a definition of the term “interest” for purposes of the Article that is identical to that provided in paragraph 5 of Article 11 of the existing Convention. The term “interest” as used in Article 11 is defined in paragraph 4 to include, inter alia, income from debt claims of every kind, whether or not secured by a mortgage and whether or not carrying a right to participate in the debtor’s profits. The term does not, however, include amounts that are treated as dividends under Article 10.

The term interest also includes amounts subject to the same tax treatment as income from money lent under the law of the State in which the income arises. Thus, for purposes of the Convention, amounts that the United States will treat as interest include (i) the difference between the issue price and the stated redemption price at maturity of a debt instrument (i.e., original issue discount (“OID”)), which may be wholly or partially realized on the disposition of a debt instrument (section 1273), (ii) amounts that are imputed interest on a deferred sales contract (section 483), (iii) amounts treated as interest or OID under the stripped bond rules (section 1286), (iv) amounts treated as OID under the below-market interest rate rules (section 7872), (v) a partner’s distributive share of a partnership’s interest income (section 702), (vi) the interest portion of periodic payments made under a “finance lease” or

similar contractual arrangement that in substance is a borrowing by the nominal lessee to finance the acquisition of property, (vii) amounts included in the income of a holder of a residual interest in a REMIC (section 860E), because these amounts generally are subject to the same taxation treatment as interest under U.S. tax law, and (viii) interest with respect to notional principal contracts that are recharacterized as loans because of a “substantial non-periodic payment.”

*Paragraph 5 of New Article 11*

Paragraph 5 of new Article 11 is identical in substance to paragraph 6 of Article 11 of the existing Convention. Paragraph 5 of new Article 11 provides an exception to paragraphs 1 and 2 of new Article 11 where the beneficial owner of the interest carries on business through a permanent establishment in the Contracting State in which the interest arises and the interest is attributable to that permanent establishment. In such cases, the applicable provisions of Article 7 of the existing Convention will apply.

The provisions of paragraph 4 of the Protocol of 2003 apply to income described in this paragraph. For example, interest income that is attributable to a permanent establishment and that accrues during the existence of the permanent establishment, but is received after the permanent establishment no longer exists, remains taxable under the provisions of Article 7 of the existing Convention, and not under this Article.

*Paragraph 6 of New Article 11*

Paragraph 6 of new Article 11 is identical to paragraph 8 of Article 11 of the existing Convention. Paragraph 6 of new Article 11 provides that, in cases involving special relationships between persons, Article 11 applies only to that portion of the total interest payments between those persons that would have been made absent such special relationships (i.e., an arm’s-length interest payment). The term “special relationship” is not defined in the Convention. In applying this paragraph, the United States considers the term to include the relationships described in Article 9 of the existing Convention, which in turn correspond to the definition of “control” for purposes of section 482 of the Code. This is consistent with paragraph 33 of the Commentary to Article 11 of the OECD Model.

Paragraph 6 of new Article 11 also provides that any amount of interest paid in excess of the amount that would be paid absent a special relationship may be taxable in the Contracting State in which it arises at a rate not to exceed 5 percent. This rule is similar to rules provided in paragraph 4 of Article 12 and paragraph 3 of Article 21 of the existing Convention, which provide that any amount paid in excess of the amount that would have been paid absent a special relationship may be taxable in the Contracting State in which they arise at a rate not to exceed 5 percent.

The Convention’s treatment of such excess amounts is consistent in most circumstances with the results under the U.S. Model and U.S. domestic law and practice. Absent the specific rule in the Convention, in most cases the United States would treat such excess amounts as a dividend or as a contribution to capital, depending on the relationship between the parties, and tax such amounts accordingly. Under the Convention, a maximum 5 percent with-

holding tax rate generally applies to dividends where the beneficial owner is a company owning directly or indirectly at least 10 percent of the voting stock of the company paying the dividends. In Japan, the general practice in the context of investment income such as interest, dividends, or other income is to impose withholding taxes on the amount in excess of the arm's-length amount at the domestic rate. Thus, for example, if a Japanese company makes an interest payment to its non-Japanese parent company, and Japan determines that the amount of the interest payment exceeded an arm's-length amount, Japan will deny a deduction for the excess amount and treat the excess amount as an interest payment subject to the appropriate withholding rate applicable to interest paid by Japanese companies under its domestic law, which is generally 20 percent. Under the Convention, such excess amounts instead are subject to a maximum 5 percent rate of withholding taxes.

Paragraph 6 of new Article 11 does not address cases where, owing to a special relationship between the payer and the beneficial owner, or between both of them and some other person, the amount of the interest is less than an arm's-length amount. In those cases a transaction may be characterized to reflect its substance and interest may be imputed consistent with the definition of interest in paragraph 4 of new Article 11. Consistent with Article 9 of the existing Convention, the United States would apply section 482 or 7872 of the Code to determine the amount of imputed interest in those cases.

*Paragraph 7 of New Article 11*

Paragraph 7 of new Article 11 is identical to paragraph 11 of Article 11 of the existing Convention. Paragraph 7 of new Article 11 provides that a resident of a Contracting State shall not be considered the beneficial owner of interest in certain "back-to-back" loan arrangements. The benefits of Article 11 therefore are not available with respect to such interest. This rule is similar to rules dealing with interest, royalties, and other income in paragraph 11 of Article 10, paragraph 5 of Article 12, and paragraph 4 of Article 21 of the existing Convention. These limited "anti-conduit" rules and their interaction with U.S. domestic law are discussed in the technical explanation of paragraph 11 of Article 10 of the existing Convention.

Paragraph 7 of new Article 11 provides that a resident of a Contracting State shall not be considered the beneficial owner of interest in respect of a debt-claim if such debt-claim would not have been established unless a person that is not entitled to the same or more favorable treaty benefits and that is not a resident of either Contracting State held an equivalent debt-claim against the resident. The operation of this rule can be illustrated in the following examples:

Example 1. A, a U.S. resident, holds a debt-claim against X, a Japanese company, that entitles A to interest of 10x each year. B, a resident of a third country that does not have a tax treaty with Japan, owns a debt-claim against A that entitles B to interest of 10x each year and otherwise has terms that are equivalent to the terms of the debt-claim held by A. A would not have established its debt-claim against X if B did not hold a debt-claim against A.

X pays interest of 10x to A, which pays interest of 10x to B. Under paragraph 11, A will not be considered the beneficial owner of the interest from X, and therefore is not entitled to treaty benefits with respect to the interest from X.

Example 2. The facts are the same as the facts of Example 1, except that, instead of owning a debt-claim against A, B holds preferred stock in A that entitles B to 10x each year to the extent of A's earnings in that year. A pays dividends of 10x to B. Paragraph 11 does not apply to deny treaty benefits to A with respect to the interest from X.

No inference is intended as to the result of Example 2 in cases of interest arising in the United States under U.S. domestic anti-abuse rules (e.g., the anti-conduit rules and other anti-abuse rules referred to in the Technical Explanation of paragraph 11 of Article 10 of the existing Convention).

#### *Relation to Other Articles*

Notwithstanding the foregoing limitations on source country taxation of interest, the saving clause of subparagraph 4(a) of Article 1 of the existing Convention permits the United States to tax its residents and citizens, subject to the special foreign tax credit rules of paragraph 3 of Article 23 of the existing Convention, as if the Convention had not come into force.

The benefits of this Article are also subject to the provisions of Article 22 of the existing Convention. Thus, if a resident of Japan is the beneficial owner of interest paid by a U.S. corporation, the resident must qualify for treaty benefits under at least one of the tests of Article 22 in order to receive the benefits of this Article.

#### ARTICLE V

Article V of the Protocol makes amendments to Article 13 of the existing Convention.

##### *Paragraph 1*

Paragraph 1 of Article V replaces paragraph 2 of Article 13 of the existing Convention with a new paragraph 2. This paragraph defines the term "real property situated in the other Contracting State." Subparagraph (a) of new paragraph 2 provides that the term includes real property referred to in Article 6 (i.e., an interest in the real property itself). Subparagraph (b) provides that when "the other Contracting State" referenced in paragraph 1 of Article 13 of the existing Convention is Japan, the term includes shares or interests in a company, partnership or trust deriving the value of its property directly or indirectly principally from real property in Article 6 and situated in Japan. Subparagraph (c) provides that when "the other Contracting State" referenced in paragraph 1 of Article 13 of the existing Convention is the United States, the term includes a "United States real property interest."

Under section 897(c) of the Code, the term "United States real property interest" includes shares in a U.S. corporation that owns sufficient U.S. real property interests to satisfy an asset-ratio test on certain testing dates. The term also includes certain foreign corporations that have elected to be treated as U.S. corporations for this purpose. See section 897(i) of the Code. In addition, any distribution made by a U.S. real estate investment trust or certain

U.S. regulated investment companies is taxable under paragraph 1 of Article 13 of the existing Convention (rather than under Article 10 (Dividends) of the existing Convention) to the extent that it is attributable to gains derived from the alienation of U.S. real property interests. See section 897(h) of the Code.

*Paragraph 2*

Paragraph 2 of Article V replaces paragraph 4 of Article 13 of the existing Convention. The only change is to delete references to paragraph 2 of Article 13 of the existing Convention that are no longer necessary. Article VI

Article VI of the Protocol restates Article 15 of the existing Convention. The restatement was necessary in order to provide an opportunity to correct an error in the Japanese language text of the existing Convention.

Paragraph 3 of the Exchange of Notes contains two understandings between the Contracting States regarding the interpretation of Article 15 of the Convention. First, it is understood that if a resident of a Contracting State does not serve as a member of a board of directors of a company, Article 15 of the Convention shall not apply to his remuneration, regardless of his title or position. Second, it is understood that where a member of the board of directors of a company also has other functions (for example, as ordinary employee, advisory, or consultant) with the company, Article 15 of the Convention does not apply to remuneration paid to such person on account of such other functions.

ARTICLE VII

Article VII of the Protocol deletes Article 20 of the existing Convention, which provides certain benefits for residents of one Contracting State who are temporarily present in the other Contracting State for the purpose of teaching or conducting research. This change is intended to bring the existing Convention into closer conformity with the current tax treaty policies of both the United States and Japan. Paragraph 5 of Article XV of the Protocol ensures that individuals who are receiving benefits under Article 20 at the time the Protocol enters into force will continue to be entitled to such benefits until such time as they would have ceased to be entitled to the benefits if the Protocol had not entered into force.

ARTICLE VIII

Article VIII of the Protocol modifies subparagraph 5(b)(i) of Article 22 of the Convention. This subparagraph defines the term “recognized stock exchange” in the case of Japan for purposes of applying Article 22. The amendment in Article VIII replaces the reference to “the Securities and Exchange Law” with the legislation’s current name, “the Financial Instruments and Exchange Law.”

ARTICLE IX

Article IX of the Protocol replaces paragraph 1 of Article 23 of the existing Convention in order to bring the Convention into conformity with Japan’s current statutory rules for providing relief from double taxation. New Subparagraph 1(a) of Article 23



Japan agrees, in new subparagraph 1(a) of Article 23, to allow to its residents, subject to its relevant domestic laws, a credit against Japanese tax for U.S. taxes paid in accordance with the provisions of the Convention. For this purpose, the U.S. taxes covered by new subparagraph 1(b) of Article 23 and paragraph 2 of Article 2 of the existing Convention are within the definition of “United States tax.” The amount of credit, however, shall not exceed that part of the Japanese tax which is appropriate to that income.

The last sentence of new subparagraph 1(a) provides a re-sourcing rule for income covered by this subparagraph. This provision is intended to ensure that a Japanese resident can obtain a Japanese foreign tax credit for U.S. taxes paid when the Convention assigns to the United States primary taxing rights over an item of income. The last sentence provides that, if the Convention allows the United States to tax an item of income beneficially owned by a resident of Japan, that income will be deemed to arise from sources in the United States for Japanese foreign tax credit purposes. However, paragraph 3 of Article 23 of the existing Convention provides special rules regarding relief of double taxation where a resident of Japan is a U.S. citizen, a former U.S. citizen, or a former U.S. long-term resident and is subject to tax in the United States solely by reason of the provisions of paragraph 4 of Article 1 of the existing Convention.

*New Subparagraph 1(b) of Article 23*

Under new subparagraph 1(b) of Article 23, Japan agrees to exclude from the basis upon which the Japanese tax is imposed certain dividends paid by a company which is a resident of the United States to a company resident in Japan. This benefit is subject to the provisions, other than the provisions with regard to share ownership requirements, of Japan’s domestic law regarding the exclusion of dividends from the basis upon which the Japanese tax is imposed. In order for subparagraph 1(b) to apply to exclude a dividend from Japanese tax, the Japanese company receiving the dividend must have owned at least 10 percent of the total shares issued by the U.S. company paying the dividend for a period of at least six months immediately before the day when the obligation to pay the dividends is confirmed.

ARTICLE X

Article X of the Protocol makes non-substantive amendments to Article 24 of the existing Convention in order to conform to changes made to Article 11 dealing with the taxation of interest.

*Paragraph 1*

Paragraph 1 of Article X amends paragraph 3 of Article 24 of the existing Convention by deleting the words “paragraph 8 of Article 11” and replacing them with the words “paragraph 6 of Article 11”.

*Paragraph 2*

Paragraph 2 of Article X amends paragraph 5 of Article 24 of the existing Convention by deleting the words “or paragraph 10 of Article 11”.

## ARTICLE XI

Article XI of the Protocol adds new paragraphs 5 through 7 to Article 25 of the existing Convention, which deals with the mutual agreement procedure. In particular, Article XI of the Protocol incorporates into Article 25 rules that provide for mandatory binding arbitration to resolve certain cases that the competent authorities of the Contracting States have been unable to resolve after negotiating for a reasonable amount of time.

The mandatory binding arbitration provision is an extension of (as opposed to an alternative to) the interaction between the competent authorities as provided in the mutual agreement procedure. Accordingly, only cases that have first been negotiated by the competent authorities pursuant to Article 25 shall be eligible for arbitration. Any case for which the competent authorities have undertaken negotiation pursuant to either paragraph 1 or paragraph 3 of Article 25 shall be eligible for arbitration, subject to the provisions of subparagraph 6(c) of Article 25.

*New Paragraph 5 of Article 25*

New paragraph 5 of Article 25 provides that a case shall be resolved through mandatory binding arbitration when (i) a person has presented a case to the appropriate competent authority under paragraph 1 of Article 24 on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of the Convention, (ii) the competent authorities have been unable to reach an agreement to resolve the case, and (iii) the conditions specified in this paragraph and in new paragraphs 6 and 7 are satisfied.

New subparagraph 14(a) of the Protocol of 2003 as amended by Article XIV of the Protocol provides that for purposes of applying new paragraph 5 of Article 25, taxation shall be considered to have resulted from “the actions of one or both of the Contracting States” as soon as tax has been paid, assessed or otherwise determined (for example, a notification of correction, determination or deficiency of a tax liability has been issued), or in cases where the taxpayer is officially notified by the tax authorities that they intend to tax him on a certain element of income (for example, a notice of proposed adjustment has been issued).

Paragraph 4 of the Exchange of Notes clarifies that the fact that tax collection procedures may have been suspended shall not affect a determination that taxation not in accordance with the provisions of the Convention has resulted from the actions of one or both Contracting States.

New subparagraphs 5(a) and 5(b) of Article 25 set forth two additional conditions that must be satisfied before a case may be resolved through arbitration. Subparagraph 5(a) provides that the presenter of the case to a competent authority must submit a written request to that competent authority for a resolution of the case through arbitration. Subparagraph 5(b) requires that all concerned persons (as defined in new paragraph 7(a) of Article 25) and their authorized representatives or agents agree in writing not to disclose to any other person, except other concerned persons, any information received during the course of the arbitration proceeding from either Contracting State or from the arbitration panel, other

than the determination of the panel. New subparagraphs 7(c) and 7(d) of Article 25 (discussed below) provide that the requirements of subparagraphs 5(a) and 5(b) of Article 25 must be satisfied prior to the beginning of the arbitration proceeding.

A confidentiality agreement may be executed by any concerned person that has the legal authority to bind any other concerned person on the matter. For example, a parent corporation with the legal authority to bind its subsidiary with respect to confidentiality may execute a comprehensive confidentiality agreement on its own behalf and that of its subsidiary.

*New Paragraph 6 of Article 25*

New paragraph 6 of Article 25 sets forth parameters according to which a case shall not be submitted to arbitration. Under subparagraph 6(a), an unresolved case shall not be submitted to arbitration if a decision on such case has already been rendered by a court or administrative tribunal of either Contracting State. Under subparagraph 6(b), an unresolved case shall not be submitted to arbitration if the competent authorities have mutually agreed before the date on which arbitration proceedings would otherwise have begun that the case is not suitable for determination by arbitration. In such cases, the competent authorities must notify the presenter of the case of such mutual agreement no later than two years after the case's commencement date (as defined in new subparagraph 7(b), described below). Subparagraph 6(c) provides that arbitration shall not be available for cases that are before the competent authorities only by virtue of the final sentence of paragraph 3 of Article 25, which provides that the competent authorities "may also consult together for the elimination of double taxation in cases not provided for in the Convention."

*New Paragraph 7 of Article 25*

New paragraph 7 of Article 25 sets forth additional rules and definitions to be used in applying the arbitration provisions. Subparagraph 7(a) defines the term "concerned person" as the person that brought the case to competent authority for consideration under Article 25 and all other persons, if any, whose tax liability to either Contracting State may be directly affected by a mutual agreement arising from that consideration. For example, a concerned person would include a U.S. corporation that brings a transfer pricing case with respect to a transaction entered into with its subsidiary in Japan for resolution to the U.S. competent authority, as well as the subsidiary, which may seek a correlative adjustment as a result of the resolution of the case.

Subparagraph 7(b) defines the term "commencement date" as the earliest date on which the information necessary to undertake substantive consideration for a mutual agreement has been received by the competent authorities of both Contracting States. The competent authority of the United States will be considered to have received the information necessary to undertake substantive consideration for a mutual agreement on the date that it has received the information that must be submitted pursuant to Rev Proc. 2006-54, 2006-2 C.B. 1035, § 4.05 (or any applicable successor procedures). The competent authority of Japan will be considered to have received the information necessary to undertake substantive consid-

eration for a mutual agreement on the date it has received the information that must be submitted pursuant to its published procedures for requesting competent authority assistance (or any applicable successor procedures). The information shall not be considered received until both competent authorities have received copies of all materials submitted to either Contracting State by the concerned person(s) in connection with the mutual agreement procedure.

Subparagraph 7(c) provides that, other than for cases described in subparagraph 7(d), an arbitration proceeding shall begin on the later of two dates: (i) two years from the commencement date of the case (unless both competent authorities have previously agreed to a different date and have notified the presenter of the case of such agreement), and (ii) the earliest date upon which the requirements of subparagraphs 5(a) and 5(b) have been satisfied (i.e., the presenter of the case has submitted a written request for resolution of the case through arbitration, and all concerned persons and their authorized representatives or agents have entered into a confidentiality agreement and the agreements have been received by both competent authorities). Clause (i) of this subparagraph permits the competent authorities to mutually agree to a different commencement date. This could be the case, for instance, if the negotiation of a case between the competent authorities were nearing completion and could be expected to be resolved in an additional short period of time, and the competent authorities mutually agreed that, if given additional time, they could resolve the case, thus avoiding the need for an arbitration proceeding. As another example, if a large number of cases would otherwise have the same commencement date, clause (i) would allow the competent authorities to agree to different commencement dates (including accelerating a commencement date) to avoid having multiple arbitration proceedings take place at the same time. Clause (i) requires the competent authorities to notify the presenter of the case of any such agreements to a different commencement date.

Subparagraph 7(d) governs the start date of arbitration with respect to a case that is the subject of a request for an advanced pricing arrangement, the terms of which the competent authorities have not been able to agree. In such cases, an arbitration proceeding shall begin on the later of two dates: i) six months after an official notification has been issued by the tax authority of either Contracting State of a correction of, or an intent to adjust, the pricing of a transaction or transfer covered by a request for an advance pricing arrangement regarding a concerned person, unless the competent authorities of both Contracting States have agreed to a different date and notified the presenter of the case of such agreement; and (ii) the earliest date upon which the requirements of subparagraphs 5(a) and 5(b) are satisfied (i.e., the presenter of the case has submitted a written request for resolution of the case through arbitration, and all concerned persons and their authorized representatives or agents have entered into a confidentiality agreement and the agreements have been received by both competent authorities). However, subparagraph 7(d) specifies that in no event shall the arbitration proceeding begin any earlier than two years after the date on which the information necessary to undertake substantive consideration for a mutual agreement on the advance

pricing arrangement has been received by the competent authorities of both Contracting States.

Subparagraph 7(e) addresses implementation of the determination of the arbitration panel. As is the case with any resolution reached pursuant to the mutual agreement procedure, the presenter of the case is not required to accept the resolution. Subparagraph 7(e) provides that if the presenter of the case accepts the determination of the arbitration panel, such determination shall constitute a resolution by mutual agreement under Article 25 of the entire case and thus shall be binding on the Contracting States. If timely accepted by the presenter of the case, the determination of the arbitration panel shall be implemented even if such implementation otherwise would be barred by the statute of limitations or by some other procedural limitation. Subparagraph 7(e), however, does not prevent the application of domestic-law procedural limitations that give effect to the agreement (e.g., a domestic law requirement that the taxpayer file a return reflecting the agreement within one year of the date of the agreement).

Subparagraph 7(f) provides that for purposes of an arbitration proceeding under new paragraphs 5, 6 and 7 of Article 25, the members of the arbitration panel and their staff shall be considered “persons or authorities” to whom information may be disclosed under Article 26 of the Convention. (See paragraph 2 of new Article 26.)

Subparagraph 7(g) sets forth the confidentiality obligations of the competent authorities regarding an arbitration proceeding. Subparagraph 7(g) provides that no information relating to an arbitration proceeding (including the arbitration panel’s determination) may be disclosed by the competent authorities, except as permitted by this Convention and the domestic laws of the Contracting States. In addition, all material prepared in the course of, or relating to, an arbitration proceeding shall be considered to be information exchanged between the Contracting States pursuant to Article 26.

Subparagraph 7(h) provides that the competent authorities shall ensure that members of the arbitration panel and their staff agree in written statements not to disclose any information relating to an arbitration proceeding (including the arbitration panel’s determination), and to abide by and be subject to the confidentiality and non-disclosure provisions of Article 26 and the applicable domestic laws of the Contracting States. In the event those provisions conflict, the most restrictive condition shall apply. These statements from the members of the arbitration panel shall also include acceptance of their appointment to the arbitration panel. The final sentence of subparagraph 7(h) makes clear that notwithstanding the provisions of subparagraph 7(h), the members of the arbitration panel or their staff shall disclose the determination of the arbitration panel to the competent authorities of both Contracting States.

Subparagraph 7(i) sets forth a non-exhaustive list of items related to the time periods and procedures related to conducting an arbitration proceeding that the competent authorities of the Contracting States must agree to in order to ensure the effective and timely implementation of the provisions of new paragraphs 5, 6 and 7 of Article 25. Such agreement must be consistent with the provisions of the Convention, and shall take the form of published

guidance before the date on which the first arbitration proceeding commences. Subparagraph 7(i) lists the following items for which the competent authorities shall agree on time frames and procedures:

- i) notifying the presenter of the case of any agreements pursuant to subparagraph 7(c)(i) or 7(d)(i) to modify the date on which an arbitration proceeding could begin;
- ii) the appropriate application of arbitration in the context of an advanced pricing arrangement, including rules concerning the date on which an arbitration proceeding shall begin for such cases;
- iii) obtaining the statements of each concerned person, authorized representative or agent, and member of the arbitration panel (including their staff) as required in subparagraphs 5(b) and 7(h), in which each such person agrees not to disclose to any other person any information received during the course of the arbitration proceeding from the competent authority of either Contracting State or the arbitration panel, other than disclosure of the determination of such panel to the competent authorities of both Contracting States;
- iv) the appointment of the members of the arbitration panel;
- v) the submission of proposed resolutions, position papers, and reply submissions by the competent authorities to the arbitration panel;
- vi) the submission by the presenter of the case of a paper setting forth the presenter's views and analysis of the case for consideration by the arbitration panel;
- vii) the delivery by the arbitration panel of its determination to the competent authorities;
- viii) the acceptance or rejection by the presenter of the case of the determination of the arbitration panel; and
- ix) the adoption by the arbitration panel of any additional procedures necessary for the conduct of its business.

Subparagraph 7(i) authorizes the competent authorities to agree in writing to such other rules and procedures as may be necessary for the effective and timely implementation of the provisions of new paragraphs 5, 6 and 7. Consistent with this authority, the competent authorities may also agree on rules necessary to implement the provisions of new paragraph 14 of the Protocol of 2003 as amended by Article XIV of the Protocol (discussed below). For the effective date for new paragraphs 5, 6, and 7 of Article 25, see paragraph 3 of Article XV of the Protocol (discussed below).

#### ARTICLE XII

Article XII of the Protocol replaces Article 26 of the existing Convention. This Article provides for the exchange of information between the competent authorities of the Contracting States. While mutual agreement procedures are addressed in Article 25, exchanges of information for purposes of the mutual agreement procedures are governed by new Article 26.

##### *Paragraph 1 of New Article 26*

The obligation to obtain and provide information to the other Contracting State is set out in paragraph 1. The information to be

exchanged is that which is foreseeably relevant for carrying out the provisions of the Convention or the domestic laws of either Contracting State concerning taxes of every kind applied at the national level. This language incorporates the standard of the OECD Model. The Contracting States intend for the phrase “is foreseeably relevant” to be interpreted to permit the exchange of information that “may be relevant” for purposes of section 7602 of the Code, which authorizes the IRS to examine “any books, papers, records, or other data which may be relevant or material.” (Emphasis added.). In *United States v. Arthur Young & Co.*, 465 U.S. 805, 814 (1984), the Supreme Court stated that the language “may be” reflects Congress’s express intention to allow the IRS to obtain “items of even potential relevance to an ongoing investigation, without reference to its admissibility.” (Emphasis in original.) However, the language “may be” would not support a request in which a Contracting State (the requesting State) simply asked for information regarding all bank accounts maintained by residents of the requesting State in the other Contracting State (the requested State). Thus, the language of paragraph 1 is intended to provide for exchange of information in tax matters to the widest extent possible, while clarifying that Contracting States are not at liberty to engage in “fishing expeditions” or otherwise to request information that is unlikely to be relevant to the tax affairs of a given taxpayer.

Consistent with the OECD Model, a request for information does not constitute a “fishing expedition” solely because it does not provide the name or address (or both) of the taxpayer under examination or investigation. In cases where the requesting State does not provide the name or address (or both) of the taxpayer under examination or investigation, the requesting State must provide other information sufficient to identify the taxpayer. Similarly, paragraph 1 does not necessarily require the request to include the name or address of the person believed to be in possession of the information.

The standard of “foreseeable relevance” can be met in cases dealing with either one taxpayer (whether identified by name or otherwise) or several taxpayers (whether identified by name or otherwise). Where a Contracting State undertakes an investigation into an ascertainable group or category of persons in accordance with its laws, any request related to the investigation will typically serve the objective of carrying out the domestic tax laws of the requesting State and thus will comply with the requirements of paragraph 1, provided it meets the standard of “foreseeable relevance.” In such cases, the requesting State should provide, supported by a clear factual basis, a detailed description of the group or category of persons and of the specific facts and circumstances that have led to the request, as well as an explanation of the applicable law and why there is reason to believe that the taxpayers in the group or category of persons for whom information is requested have been non-compliant with that law supported by a clear factual basis. The requesting State should further show that the requested information would assist in determining compliance by the taxpayers in the group or category of persons.

Exchange of information with respect to each State’s domestic law is authorized to the extent that taxation under domestic law is not contrary to the Convention. Thus, for example, information

may be exchanged even if the transaction to which the information relates is a purely domestic transaction in the requesting State and, therefore, the exchange is not made to carry out the provisions of the Convention. An example of such a case is provided in the subparagraph 8(b) of the OECD Commentary to Article 26: A company resident in one Contracting State and a company resident in the other Contracting State transact business between themselves through a third-country resident company. Neither Contracting State has a treaty with the third state. To enforce their internal laws with respect to transactions of their residents with the third-country company (because there is no relevant treaty in force), the Contracting States may exchange information regarding the prices that their residents paid in their transactions with the third-country resident.

The information that may be exchanged relates to information as is foreseeably relevant for carrying out the provisions of the Convention or the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes covered by the Convention. Thus, the competent authorities may request and provide information for cases under examination or criminal investigation, in collection, on appeals, or under prosecution.

The taxes covered by the Convention for purposes of this Article constitute a broader category of taxes than those referred to in Article 2 of the Convention. Exchange of information is authorized with respect to taxes of every kind imposed by a Contracting State at the national level. Accordingly, information may be exchanged with respect to U.S. estate and gift taxes, excise taxes or, with respect to Japan, nationally imposed value added taxes.

Information exchange is not restricted by paragraph 1 of Article 1. Accordingly, 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 Japan and that permanent establishment engages in transactions with a U.S. enterprise, the United States could request information with respect to that permanent establishment, even though the third-country resident is not a resident of either Contracting State. Similarly, if a third-country resident maintains a bank account in Japan, and the Internal Revenue Service has reason to believe that funds in that account should have been reported for U.S. tax purposes but have not been so reported, the Internal Revenue Service can request information from Japan with respect to that person's account, even though that person is not the taxpayer under examination.

Although the term "United States" does not encompass U.S. possessions or territories for most purposes of the Convention, section 7651 of the Code authorizes the Internal Revenue Service to utilize the provisions of the Code to obtain information from the U.S. possessions or territories pursuant to a proper request made under Article 26. If necessary to obtain requested information, the Internal Revenue Service could issue and enforce an administrative summons to the taxpayer, a tax authority (or a government agency in a U.S. possession or territory), or a third party located in a U.S. possession or territory.



The final sentence of paragraph 1 provides that the requesting State may specify the form in which information is to be provided (e.g., authenticated copies of original documents (including books, papers, statements, records, accounts, and writings)). The intention is to ensure that the information may be introduced as evidence in the judicial proceedings of the requesting State. The requested State shall, if possible, provide the information in the form requested to the same extent that it could obtain information in that form under its own laws and administrative practices with respect to its own taxes.

*Paragraph 2 of New Article 26*

Paragraph 2 provides assurances that any information exchanged will be treated as secret, subject to the same disclosure constraints as information obtained under the laws of the requesting State. The confidentiality rules cover competent authority letters, including the letter requesting information. At the same time, it is understood that the requested State can disclose the minimum information contained in a competent authority letter (but not the letter itself) necessary for the requested State to be able to obtain or provide the requested information to the requesting State, without frustrating the efforts of the requesting State. If, however, court proceedings or the like under the domestic laws of the requested State necessitate the disclosure of the competent authority letter itself, the competent authority of the requested State may disclose such a letter unless the requesting State otherwise specifies.

Information received may be disclosed only to persons or authorities, including courts and administrative bodies, involved in the assessment, collection, or administration of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes referred to in paragraph 1 or the oversight of such functions. The information must be used by these persons in connection with the specified functions. Information may also be disclosed to legislative bodies, such as the tax-writing committees of the U.S. Congress and the U.S. Government Accountability Office, engaged in the oversight of the preceding activities. Information received by these bodies must be for use in the performance of their role in overseeing the administration of U.S. tax laws. Information received may be disclosed in public court proceedings or in judicial decisions.

In situations in which the requested State determines that the requesting State does not comply with its duties regarding the confidentiality of the information exchanged under this Article, the requested State may suspend assistance under this Article until such time as proper assurance is given by the requesting State that those duties will indeed be respected. If necessary, the competent authorities may enter into specific arrangements or memoranda of understanding regarding the confidentiality of the information exchanged under this Article.

*Paragraph 3 of New Article 26*

Paragraph 3 provides that the obligations undertaken in paragraphs 1 and 2 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 a Contracting State required to supply information not obtainable under the laws or administrative practice of either State, or to disclose trade secrets or other information, the disclosure of which would be contrary to public policy. Finally, paragraph 3 clarifies that no obligation is imposed to obtain or provide information relating to certain confidential communications between a client and an attorney, solicitor, or other admitted legal representative.

Thus, a requesting State may be denied information from the other State if the information would be obtained pursuant to procedures or measures that are broader than those available in the requesting State. However, the statute of limitations of the requesting State should govern a request for information. Thus, the requested State should attempt to obtain the information even if its own statute of limitations has passed. In many cases, relevant information will still exist in the business records of the taxpayer or a third party, even though it is no longer required to be kept for domestic tax purposes.

While paragraph 3 states conditions under which a Contracting State is not obligated to comply with an information request from the other Contracting State, the requested State is not precluded from providing such information, and may, at its discretion, do so subject to the limitations of its internal law.

*Paragraph 4 of New Article 26*

Paragraph 4 provides that when information is requested by a Contracting State in accordance with this Article, the requested 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. In the absence of such a paragraph, some taxpayers have argued that subparagraph 3(a) prevents a Contracting State from requesting information from a bank or fiduciary that the Contracting State does not need for its own tax purposes. This paragraph clarifies that paragraph 3 does not impose such a restriction and that a Contracting State is not limited to providing only the information that it already has in its own files.

*Paragraph 5 of New Article 26*

Paragraph 5 provides that a Contracting State may not decline to provide information because that information is held by banks, other financial institutions, nominees or persons acting in an agency or fiduciary capacity or because the information relates to ownership interests in a person. Thus, paragraph 5 would effectively prevent a Contracting State from relying on paragraph 3 to argue that its domestic bank secrecy laws (or similar legislation relating to disclosure of financial information by financial institutions or intermediaries) override its obligation to provide information under paragraph 1. This paragraph also requires the disclosure of information regarding the beneficial owner of an interest in a person, such as the identity of a beneficial owner of bearer shares.

Subparagraphs 3(a) and (b) do not permit the requested State to decline a request where paragraph 4 or 5 applies. Paragraph 5 would apply, for instance, in situations in which the requested

State's inability to obtain the information was specifically related to the fact that the requested information was believed to be held by a bank or other financial institution. Thus, the application of paragraph 5 includes situations in which the tax authorities' information-gathering powers with respect to information held by banks and other financial institutions are subject to different requirements than those that are generally applicable with respect to information held by persons other than banks or other financial institutions. This would, for example, be the case where the tax authorities can only exercise their information-gathering powers with respect to information held by banks and other financial institutions in instances where specific information regarding the taxpayer under examination or investigation is available. This would also be the case where, for example, the use of information-gathering measures with respect to information held by banks and other financial institutions requires a higher probability that the information requested is held by the person believed to be in possession of the requested information than the degree of probability required for the use of information-gathering measures with respect to information believed to be held by persons other than banks or financial institutions.

Paragraph 10 of the Exchange of Notes clarifies that new Article 26 shall have effect from the date of entry into force of the Protocol without regard to the taxable year to which the matter relates, provided all of the conditions and requirements of the Article are satisfied. Thus, for example, the competent authority may seek information under new Article 26 with respect to a taxable year prior to the entry into force of the Protocol.

#### ARTICLE XIII

Article XIII of the Protocol replaces Article 27 of the existing Convention with a new Article 27. New Article 27 provides rules under which the United States and Japan will lend each other assistance in the collection of certain revenue claims, as defined in paragraph 1 of the new Article 27.

##### *Paragraph 1 of New Article 27*

Paragraph 1 provides that subject to the conditions set forth in new Article 27, the Contracting States shall lend assistance to each other in the collection of "revenue claims," defined to be taxes (insofar as the taxation is not contrary to the Convention or any other agreement to which the United States and Japan are parties), together with interest, costs of collection, additions to such taxes, and civil or administrative penalties related to such taxes. Paragraph 5 of the Exchange of Notes sets forth the understanding of the Contracting States that the obligation to lend assistance shall be satisfied in cases where the State from which assistance is requested (the requested State) had made reasonable efforts to lend assistance, but was unsuccessful in collecting the revenue claim on behalf of the State requesting assistance (the applicant State).

Collection assistance is not limited by the provisions of paragraph 1 of Article 1 of the Convention. Accordingly, assistance may be requested and provided under new Article 27 regarding revenue claims in respect of persons who are not residents of either Contracting State, provided that all of the requirements of the Article

are satisfied. For example, new Article 27 would permit the United States to request assistance from Japan regarding the collection of a finally determined revenue claim against an individual who is a resident of a third country, has assets in Japan, provided services in the United States, and filed a fraudulent U.S. tax return.

*Paragraph 2 of New Article 27*

Paragraph 2 limits the scope of revenue claims for which collection assistance may be sought pursuant to new Article 27. Subparagraph 2(a) limits the scope of revenue claims in respect of companies, and subparagraph 2(b) limits the scope of revenue claims in respect of individuals.

The benefits afforded under new Article 27 are not intended to provide a means to bypass or circumvent the application of the mutual agreement procedure as set forth in Article 25 of the Convention. Consistent with this policy, subparagraph 2(a) provides that collection assistance will be available only for the following revenue claims in respect of a company: (i) revenue claims the determination of which are not eligible to be resolved by mutual agreement procedure pursuant to Article 25; (ii) revenue claims the determination of which have been mutually agreed upon pursuant to Article 25; or (iii) revenue claims with respect to the determination of which the company has terminated the mutual agreement procedure are eligible for collection assistance.

Subparagraph 2(b) describes those revenue claims against individuals which are eligible for collection assistance. A Contracting State may request collection assistance with respect to a revenue claim against an individual who is a national of that State (or a national of a third state) without limitation other than limitations imposed by the other paragraphs of new Article 27. However, in the case of revenue claims against an individual who is a national of the requested State, collection assistance shall be provided only for revenue claims with respect to which the individual or a person acting on behalf of the individual (i) has filed a fraudulent tax return or a fraudulent claim for refund; (ii) has willfully failed to file a tax return with the intention of evading taxes; or (iii) has transferred assets into the requested State to avoid collection of the revenue claim.

*Paragraph 3 of New Article 27*

Paragraph 3, which is equivalent to Article 27 of the existing Convention, applies notwithstanding the limitations of paragraph 2. Paragraph 3 provides for assistance in collection of taxes to the extent necessary to ensure that treaty benefits are enjoyed only by persons entitled to those benefits under the terms of the Convention, provided that the requested State agrees with such determination of improper granting of treaty benefits. For example, if the payer of a U.S.-source portfolio dividend receives a Form W-8BEN or other appropriate documentation from the payee, the withholding agent is generally permitted to withhold at the reduced portfolio dividend rate of 15 percent. If, however, it is subsequently discovered that the payee is merely acting as a nominee on behalf of a third-country resident, paragraph 3 of new Article 27 would require Japan to withhold and remit to the United States

the additional tax that should have been collected by the U.S. withholding agent.

*Paragraph 4 of New Article 27*

Paragraph 4 provides that new Article 27 shall apply only to revenue claims in respect of the taxes covered by Article 2 and certain additional taxes.

In the case of Japan, the additional taxes with respect to which collection assistance may be requested are the consumption tax, the inheritance tax, and the gift tax. Paragraph 6 of the Exchange of Notes clarifies that the term “consumption tax” means only the consumption tax imposed at the national level by Japan, and does not include any consumption tax imposed by a local authority of Japan.

In the case of the United States, the additional taxes with respect to which collection assistance may be requested are the Federal estate and gift taxes, the Federal excise tax on insurance policies issued by foreign insurers, the Federal excise taxes imposed with respect to private foundations, and the Federal taxes related to employment and self-employment. Paragraph 7 of the Exchange of Notes clarifies that the term “Federal excise tax on insurance policies issued by foreign insurers” means taxes imposed pursuant to Section 4371 through 4374 of the Internal Revenue Code. Paragraph 8 of the Exchange of Notes clarifies that the term “Federal excise tax imposed with respect to private foundations” means taxes imposed pursuant to sections 4940 through 4948 of the Code. Paragraph 9 of the Exchange of Notes clarifies that the term “Federal taxes related to employment and self-employment” means taxes imposed pursuant to Chapter 2 and Chapters 21 through 23A of the Internal Revenue Code.

*Paragraph 5 of New Article 27*

Paragraph 5 requires the applicant State to certify that the revenue claim for which collection assistance is sought has been “finally determined.” For purposes of paragraph 5, a revenue claim has been finally determined when the applicant State has the right under its internal law to collect the revenue claim and all administrative and judicial rights of the taxpayer to restrain collection in the applicant State have lapsed or been exhausted.

New paragraph 15 of the Protocol of 2003 as amended by paragraph 3 of Article XIV provides that for the purposes of evaluating the final determination of a U.S. revenue claim for which the United States may request assistance pursuant to Article 27, the existence of administrative or judicial rights available to the taxpayer in connection with the finally determined revenue claim that arise after collection actions have begun, such as collection due process rights (CDP) and collection appeals rights (CAP), shall not be interpreted by Japan to mean that such revenue claim is not finally determined under U.S. principles. New paragraph 15 of the 2003 Protocol does not limit a taxpayer’s access to CDP or CAP rights with respect to collection by the United States of a U.S. revenue claim, including revenue claims for which the United States has requested collection assistance from Japan.

In the case of Japan, new paragraph 15 of the Protocol of 2003 provides that the right to take action pursuant to Article 36 of the

Administrative Case Litigation Act (Law No. 139 of 1962) of Japan shall not be interpreted by the United States to mean that such revenue claim is not finally determined under Japanese principles.

*Paragraph 6 of New Article 27*

Paragraph 6 of new Article 27 provides that when an application for assistance by the applicant State has been accepted for collection by the requested State pursuant to the provisions of Article 27, the revenue claim of the applicant State shall be treated, to the extent necessary for collection under the laws of the requested State, as assessed under the laws of the requested State as of the time the application is received, and shall be collected by the requested State as though such revenue claim were the requested State's own revenue claim in accordance with the laws applicable to the collection of the requested State's own revenue claims.

*Paragraph 7 of New Article 27*

Paragraph 7 of new Article 27 provides that notwithstanding the provisions of paragraph 6, acts of collection carried out by the requested State in pursuance of an application for assistance, which, according to the laws of the applicant State, would have the effect of suspending or interrupting the period of limitation on the collection of a revenue claim in the applicant State if carried out by the applicant State, shall also have this effect with respect to the revenue claim under the laws of the applicant State. For example, assume that in the pursuance of an application for assistance, the competent authority of the requested State had reached an agreement with the taxpayer to enter into a plan under which the revenue claim would be paid over time in a series of installments. If under the administrative practices of the applicant State, the use of an installment agreement would have the effect of extending the applicant State's statute of limitations for collection, then by virtue of this paragraph 7, the conclusion of an installment agreement between the taxpayer and the requested State shall have the effect of extending the statute of limitations in the applicant State. Paragraph 7 obligates the requested State to inform the applicant State about such acts.

*Paragraph 8 of New Article 27*

Paragraph 8 of new Article 27 provides that the time limits of the requested State, i.e., time limitations beyond which a revenue claim cannot be enforced or collected, shall not apply to a revenue claim in respect of which the applicant State has made a request under this Article. Only the time limits of the applicant State are applicable. Thus, as long as a revenue claim can still be enforced or collected in the applicant State, the requested State may not refuse to pursue a request based on its own time limits. Paragraph 8 applies notwithstanding paragraph 6 of new Article 27, which requires the requested State to generally treat the revenue claim of the applicant State as its own revenue claim.

Paragraph 8 also provides that the rules of the requested State giving its own revenue claims priority over the claims of other creditors shall not apply to a revenue claim in respect of which a request for assistance has been made under new Article 27. Such

rules are often included in domestic laws to ensure that tax authorities can collect taxes to the fullest possible extent.

The words “by reason of its nature as such” found at the end of the paragraph indicate that the time limits and priority rules of the requested State to which the paragraph applies are only those that are specific to unpaid taxes. Thus, the paragraph does not prevent the application of general rules concerning time limits or priority that would apply to all debts (e.g., rules giving priority to a claim by reason of that claim having arisen or having been registered before another claim).

*Paragraph 9 of New Article 27*

Paragraph 9 of new Article 27 provides that nothing in Article 27 shall be construed as creating in the requested State any rights of administrative or judicial review of the applicant State’s finally determined revenue claim. Thus, when an application for collection assistance has been accepted, the substantive validity of the applicant State’s revenue claim cannot be challenged in an action in the requested State, irrespective of any such rights that may be available under the laws of either Contracting State.

*Paragraph 10 of New Article 27*

Paragraph 10 of new Article 27 provides that if, at any time pending execution of an application for assistance under Article 27, the applicant State loses the right under its domestic law to collect the revenue claim or otherwise terminates collection, the competent authority of the applicant State shall promptly withdraw the application for assistance in collection and the requested State shall cease all measures of collection of the revenue claim.

*Paragraph 11 of New Article 27*

Paragraph 11 of new Article 27 provides that if, at any time pending execution of an application for assistance under Article 27, the applicant State suspends collection of the revenue claim according to the laws of the applicant State, the competent authority of the applicant State shall promptly notify the competent authority of the requested State of that fact, and the competent authority of the applicant State shall either suspend or withdraw its request at the option of the competent authority of the requested State and the requested State shall suspend or cease all measures of collection of the revenue claim accordingly.

*Paragraph 12 of New Article 27*

Paragraph 12 of new Article 27 provides that amounts collected by the requested State pursuant to this Article shall be remitted to the competent authority of the applicant State.

*Paragraph 13 of New Article 27*

Paragraph 13 of new Article 27 provides that unless the competent authorities of both Contracting States otherwise agree, the ordinary costs incurred in providing assistance in collection shall be borne by the requested State, and any extraordinary costs so incurred shall be borne by the applicant State.

*Paragraph 14 of New Article 27*

Paragraph 14 of new Article 27 sets forth limitations on the obligations imposed on the requested State. The requested State is at liberty to refuse to provide assistance in the cases referred to in the paragraph. However, if it does provide assistance in these cases, it remains within the framework of the Article and it cannot be objected that this State has failed to observe the provisions of the Article.

In the first place, the paragraph provides that a Contracting State is not bound to go beyond its own internal laws and administrative practice or those of the other State in fulfilling its obligations under the Article. However, types of administrative measures authorized for the purpose of the requested State's tax must be utilized, even though invoked solely to provide assistance in the collection of taxes owed to the requesting State.

Paragraph 8 of this Article provides that a Contracting State's time limits will not apply to a revenue claim in respect of which the other State has requested assistance. Subparagraph 14(a) is not intended to defeat that principle. Providing assistance with respect to a revenue claim after the requested State's time limits have expired will not, therefore, be considered to be at variance with the laws and administrative practice of that or of the other Contracting State in cases where the time limits applicable to that claim have not expired in the requesting State.

Subparagraph 14(b) includes a limitation to carrying out measures contrary to public policy.

*Paragraph 15 of New Article 27*

Paragraph 15 of new Article 27 sets forth additional limitations on the obligations imposed on the requested State. Under subparagraph 15(a), the requested State is not obliged to satisfy a request for assistance if the applicant State has not pursued all reasonable measures of collection available under its laws or administrative practices. Under subparagraph 15(b), the requested State may also reject a request for assistance for practical considerations, for instance if the costs that it would incur in collecting a revenue claim of the requesting State would exceed the amount of the revenue claim.

*Paragraph 16 of New Article 27*

Paragraph 16 of new Article 27 mandates the competent authorities of both Contracting States to reach a written agreement on the mode of application of the Article before any assistance shall be lent under the Article other than pursuant to paragraph 3. The written agreement shall include: 1) measures to ensure comparable levels of assistance to each Contracting State; 2) a limit to the number of applications for assistance that a Contracting State may make in a particular year; and 3) minimum monetary thresholds for a revenue claim for which assistance is sought. In addition, the written agreement shall also set forth procedural rules related to the remittance of amounts collected pursuant to the provisions of the Article.

Paragraph 10 of the Exchange of Notes clarifies that new Article 27 shall have effect from the date of entry into force of the Protocol without regard to the taxable year to which the revenue claim re-



lates, provided all of the conditions and requirements of the Article are satisfied. Thus, for example, a Contracting State could request assistance under new Article 27 with respect to a revenue claim that arose prior to the entry into force of the Protocol.

#### ARTICLE XIV

Article XIV of the Protocol makes numerous amendments to the Protocol of 2003.

##### *Paragraph 1*

Paragraph 1 of Article XIV of the Protocol makes two non-substantive changes to paragraph 1 of the Protocol of 2003. The two references to “United States excise tax” are replaced with the term “Federal excise tax.” Paragraph 7 of the Exchange of Notes clarifies that for purposes of revised paragraph 1 of the Protocol of 2003, the term “Federal excise tax on insurance policies issued by foreign insurers” means taxes imposed pursuant to Section 4371 through 4374 of the Internal Revenue Code. Paragraph 8 of the Exchange of Notes clarifies that for purposes of revised paragraph 1 of the Protocol of 2003, the term “Federal excise tax imposed with respect to private foundations” means taxes imposed pursuant to Section 4940 through 4948 of the Internal Revenue Code.

##### *Paragraph 2*

Paragraph 2 of Article XIV of the Protocol deletes paragraph 9 of the Protocol of 2003 in order to conform with changes relating to capital gains that Article V of the Protocol makes to Article 13 of the Convention.

##### *Paragraph 3*

Paragraph 3 of Article XIV of the Protocol adds two new paragraphs to the Protocol of 2003. New paragraph 14 of the Protocol of 2003 (discussed below) sets forth a number of clarifications and rules regarding the application of the mandatory binding arbitration provisions in new paragraphs 5, 6 and 7 of Article 25 of the Convention as modified by Article XI of the Protocol. New paragraph 15 of the Protocol of 2003 is discussed above in the explanation of paragraph 5 of new Article 27 of the Convention.

##### *New Subparagraph 14(a) of the Protocol of 2003*

New subparagraph 14(a) of the Protocol of 2003 is discussed above in the explanation of new paragraph 5 of Article 25 of the Convention as amended by Article XI of the Protocol.

##### *New Subparagraph 14(b) of the Protocol of 2003*

New subparagraph 14(b) of the Protocol of 2003 sets forth rules that the competent authorities shall follow for selecting the members of the arbitration panel. The arbitration panel shall consist of three individual members. The members appointed shall not be employees nor have been employees within the twelve-month period prior to the date on which the arbitration proceeding begins, of the tax administration, the Ministry of Finance or the Treasury Department of the Contracting State which identifies them. Each competent authority shall select one member of the arbitration panel. In the event that the competent authority of one Contracting

State fails to select a member for the arbitration panel in the manner and within the time periods agreed by the competent authorities pursuant to new subparagraph 7(i)(iv) of Article 25 of the Convention, the competent authority of the other Contracting State shall select a second member. The two members of the arbitration panel who have been selected shall select the third member, who shall serve as Chair of the arbitration panel. If the two initial members of the arbitration panel fail to select the third member in the manner and within the time periods agreed by the competent authorities pursuant to new subparagraph 7(i)(iv) of Article 25 of the Convention, these members shall be dismissed, and each competent authority shall select a new member of the arbitration panel. The Chair shall not be a national or lawful permanent resident of either Contracting State. Furthermore, the members appointed shall not have any prior involvement with the specific matters at issue in the proceeding for which they are being considered as arbitrators.

*New subparagraph 14(c) of the Protocol of 2003*

New subparagraph 14(c) of the Protocol of 2003 sets forth conditions under which the arbitration process with respect to particular cases shall terminate. Subparagraph 14(c)(i) provides that an arbitration proceeding with respect to a case shall terminate if the competent authorities reach a mutual agreement to resolve the case. Subparagraph 14(c)(ii) provides that an arbitration proceeding with respect to a case shall terminate if the presenter of the case withdraws his request for arbitration. Subparagraph 14(c)(iii) provides that an arbitration proceeding with respect to a case shall terminate if a decision concerning the case is rendered by a court or administrative tribunal of one of the Contracting States during the arbitration proceeding. Subparagraph 14(c)(iv) provides that an arbitration proceeding with respect to a case shall terminate if any concerned person or their authorized representatives or agents willfully violates the written nondisclosure statement required by new subparagraph 5(b) of Article 25, and the competent authorities of both Contracting States agree that such violation should result in the termination of the arbitration proceeding.

*New Subparagraph 14(d) of the Protocol of 2003*

Subparagraph 14(d) of the Protocol of 2003 sets forth the rules governing the submission of proposed resolutions for consideration by the arbitration panel. Each competent authority shall be permitted to submit a proposed resolution addressing each adjustment or similar issue raised in the case. Such proposed resolution shall be a resolution of the entire case and shall reflect without modification all matters in the case previously agreed between the competent authorities. Such proposed resolution shall be limited to a disposition of specific monetary amounts (for example, of income, profit, gain or expense) or, where specified, the maximum rate of tax charged pursuant to the Convention for each adjustment or similar issue in the case. Each competent authority shall also be permitted to submit a supporting position paper for consideration by the arbitration panel.

*New Subparagraph 14(e) of the Protocol of 2003*

New subparagraph 14(e) of the Protocol of 2003 provides a special rule for proposed resolutions involving an initial determination of a threshold question (such as the existence of a permanent establishment). Subparagraph 14(e) provides that notwithstanding the provisions of subparagraph 14(d) of the Protocol of 2003, it is understood that, in the case of an arbitration proceeding concerning: (i) the tax liability of an individual with respect to whose State of residence the competent authorities have been unable to reach agreement; (ii) the taxation of the business profits of an enterprise with respect to which the competent authorities have been unable to reach an agreement on whether a permanent establishment exists; or (iii) such other issues the determination of which are contingent on resolution of similar threshold questions, the proposed resolutions and position papers may include positions regarding (i), (ii) or (iii) above, in addition to proposed resolutions limited to specific monetary amounts (for example, of income, profit, gain or expense) or, where specified, the maximum rate of tax charged pursuant to the Convention due as a consequence of the arbitration panel's determination regarding residency, the existence of a permanent establishment or other threshold questions. The determination of the arbitration panel regarding the threshold question may preclude the need for a further determination regarding specific monetary amounts or the maximum rate of tax.

*New Subparagraph 14(f) of the Protocol of 2003*

New subparagraph 14(f) of the Protocol of 2003 provides that where an arbitration proceeding concerns a case comprising multiple adjustments or issues each requiring a disposition of specific monetary amounts of income, profit, gain or expense or, where specified, the maximum rate of tax charged pursuant to the Convention, the proposed resolution may propose a separate disposition for each adjustment or similar issue. This flexibility permits each adjustment or issue to be resolved independently through the arbitration proceeding, such that the determination of the arbitration panel will constitute a mutual agreement of the entirety of the issues in the case.

*New Subparagraph 14(g) of the Protocol of 2003*

New subparagraph 14(g) of the Protocol of 2003 provides that each competent authority shall receive the proposed resolution and position paper submitted by the other competent authority, and shall be permitted to submit a reply submission to the arbitration panel. Each competent authority shall also receive the reply submission of the other competent authority.

*New Subparagraph 14(h) of the Protocol of 2003*

New subparagraph 14(h) of the Protocol of 2003 provides that the presenter of the case shall be permitted to submit for consideration by the arbitration panel a paper setting forth the presenter's analysis and views of the case. The submission by the presenter of the case is not a proposed resolution that the arbitration panel could select in making its determination. The submission by the presenter may not include any information not provided to the competent authorities prior to the initiation of the arbitration pro-

ceeding. The competent authorities shall determine an appropriate time frame for submission of such paper by the presenter in order to ensure that the competent authorities have sufficient time to consider the information.

*New Subparagraph 14(i) of the Protocol of 2003*

New subparagraph 14(i) of the Protocol of 2003 provides that the arbitration panel shall deliver a determination in writing to the competent authorities. The determination reached by the arbitration panel in the arbitration proceeding shall be limited to one of the proposed resolution submitted by one competent authority for each adjustment or similar issue and any threshold questions, and shall not include a rationale or any other explanation of the determination. The determination of the arbitration panel shall have no precedential value with respect to the application of the Convention in any other case.

*New Subparagraph 14(j) of the Protocol of 2003*

New subparagraph 14(j) of the Protocol of 2003 provides that unless the competent authorities of both Contracting States agree to a longer time period, the presenter of the case shall have 45 days from receiving the determination of the arbitration panel to notify, in writing, the competent authority of the Contracting State to whom the case was presented, his acceptance of the determination. In the event the case is pending in litigation and the presenter desires to accept the determination, each concerned person who is a party to the litigation must also advise, within the same time frame, the relevant court of its acceptance of the determination of the arbitration panel as the resolution by mutual agreement and its intention to withdraw from the consideration of the court the issues resolved through the proceeding. If any concerned person fails to so advise the relevant competent authority and relevant court within this time frame, the determination of the arbitration panel shall be considered not to have been accepted by the presenter of the case. Where the determination of the arbitration panel is not accepted, the case will not be eligible for any subsequent further consideration by the competent authorities.

*New Subparagraph 14(k) of the Protocol of 2003*

New subparagraph 14(k) of the Protocol of 2003 provides that the fees and expenses of the members of the arbitration panel, as well as any costs incurred in connection with the proceeding by the Contracting States, shall be borne equitably by the competent authorities.

ARTICLE XV

This Article contains rules for bringing the Protocol into force and giving effect to its provisions.

*Paragraph 1*

Paragraph 1 provides for the ratification of the Protocol by both Contracting States according to their constitutional and statutory requirements. The Protocol shall enter into force on the date that the Contracting States exchange instruments of ratification.

In the United States, the process leading to ratification and entry into force is as follows: Once a treaty has been signed by authorized representatives of the two Contracting States, the Department of State sends the treaty to the President who formally transmits it to the Senate for its advice and consent to ratification, which requires approval by two-thirds of the Senators present and voting. Prior to this vote, however, it generally has been the practice for the Senate Committee on Foreign Relations to hold hearings on the treaty and make a recommendation regarding its approval to the full Senate. Both Government and private sector witnesses may testify at these hearings. After the Senate gives its advice and consent to ratification of the protocol or treaty, an instrument of ratification is drafted for the President's signature. The President's signature completes the process in the United States.

*Paragraph 2*

The date on which a treaty enters into force is not necessarily the date on which its provisions take effect. Paragraph 2, therefore, provides rules regarding when the provisions of the Protocol will have effect.

Under subparagraph 2(a), the Protocol will have effect with respect to taxes withheld at source (principally dividends, interest and royalties) for amounts paid or credited on or after the first day of the third month following the date on which the Convention enters into force. For example, if instruments of ratification are exchanged on April 25 of a given year, the withholding rates specified in new Article 11 of the Convention would be applicable to any interest paid or credited on or after July 1 of that year. This rule allows the benefits of the withholding reductions to be put into effect as soon as possible, without waiting until the following calendar year. The two- to three-month delay is required to allow sufficient time for withholding agents to be informed about the change in withholding rates. If, after the provisions regarding taxes withheld at source have entered into force, a U.S. withholding agent withholds at a higher rate than that provided by the Convention (perhaps because the withholding agent was not able to re-program its computers before the payment was made), a beneficial owner of the income that is a resident of Japan may make a claim for refund pursuant to section 1464 of the Code.

For all other taxes, subparagraph 2(b) specifies that the Protocol will have effect for any taxable period beginning on or after January 1 of the year following entry into force.

*Paragraph 3*

Paragraph 3 provides that notwithstanding the provisions of paragraph 2, the mandatory binding arbitration rules provided in new paragraphs 5, 6 and 7 of Article 25 of the Convention as amended by Article XI of the Protocol shall have effect with respect to (a) cases that are under consideration by the competent authorities as of the date on which the Protocol enters into force and (b) cases that come under such consideration after the date on which the Protocol enters into force. Thus, the mandatory binding arbitration rules may apply with respect to tax liabilities (or potential tax liabilities) arising before the Protocol enters into force.

With respect to cases that are under consideration by the competent authorities as of the date on which the Protocol enters into force, the commencement date (defined in new paragraph 7(b) of Article 25) shall be the date on which the Protocol enters into force. As a result, cases that are open and unresolved as of the entry into force of the Protocol will go into binding arbitration on the later of two years after the entry into force of the Protocol (unless both competent authorities have previously agreed to a different date) and the earliest date upon which all the agreements required by new subparagraph 7(c) of Article 25 have been received by both competent authorities.

*Paragraph 4*

Paragraph 4 contains special rules regarding the effective dates of the provisions of revised Articles 26 and 27 of the Convention as amended by Articles XII and XIII respectively of the Protocol. Notwithstanding the provisions of paragraph 2 of this Article XV, the provisions of revised Articles 26 and 27 shall have effect from the date of entry into force of the Protocol, and as clarified by paragraph 10 of the Exchange of Notes, without regard to the matter or revenue claim to which the request relates, provided all of the conditions and requirements of the respective Articles are satisfied.

*Paragraph 5*

Paragraph 5 provides that notwithstanding the entry into force of the Protocol, an individual who is entitled to the benefits of Article 20 of the existing Convention (relating to teachers and researchers) at the time of the entry into force of the Protocol shall continue to be entitled to such benefits until such time as the individual would have ceased to be entitled to such benefits if the Protocol had not entered into force.

*Paragraph 6*

Paragraph 6 provides that the Protocol shall remain in effect as long as the Convention remains in force.