AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

108TH CONGRESS
1st Session

SENATE

TREATY DOC.
108–3

SECOND ADDITIONAL PROTOCOL MODIFYING CONVENTION WITH MEXICO REGARDING DOUBLE TAXATION AND PREVENTION OF FISCAL EVASION

MESSAGE

FROM

THE PRESIDENT OF THE UNITED STATES

TRANSMITTING

SECOND ADDITIONAL PROTOCOL THAT MODIFIES THE CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE UNITED MEXICAN STATES FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME, SIGNED AT MEXICO CITY ON NOVEMBER 26, 2002



FEBRUARY 25, 2003.—The Protocol was read the first time, and together with the accompanying papers, referred to the Committee on Foreign Relations and orderd to be printed for the use of the Senate.

U.S. GOVERNMENT PRINTING OFFICE

19–112 WASHINGTON : 2003

LETTER OF TRANSMITTAL

THE WHITE HOUSE, *February 25, 2003.*

To the Senate of the United States:

I transmit herewith for Senate advice and consent to ratification, the Second Additional Protocol that Modifies the Convention Between the Government of the United States of America and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, signed at Mexico City on November 26, 2002. I also transmit, for the information of the Senate, the report of the Department of State concerning the proposed Protocol.

The Convention, as amended by the proposed Protocol, would be similar to tax treaties between the United States and other developed nations. It would provide maximum rates of tax to be applied to various types of income and protection from double taxation of income. The Protocol was concluded in recognition of the importance of the United States economic relations with Mexico.

I recommend that the Senate give early and favorable consideration to this Protocol, and that the Senate give its advice and consent to ratification.

GEORGE W. BUSH.

LETTER OF SUBMITTAL

DEPARTMENT OF STATE,
Washington, February 12, 2003.

The PRESIDENT,
The White House.

THE PRESIDENT: I have the honor to submit to you, with a view to its transmission to the Senate for advice and consent to ratification, the Second Additional Protocol that Modifies the Convention between the Government of the United States of America and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, signed at Mexico City on November 26, 2002 (the "Protocol").

The proposed Protocol with Mexico was negotiated to bring the existing Income Tax Convention, concluded in 1992 with a Protocol and amended by an Additional Protocol in 1994, up to date and in closer conformity with current U.S. tax treaty policy. The Convention, as amended by the proposed Protocol, would provide for maximum rates of tax to be applied to various types of income and protection from double taxation of income. The withholding tax rates on investment income in the proposed Protocol are the same or lower than those in the existing Convention.

Pursuant to Article II of the proposed Protocol, replacing Article 10 of the existing Convention, new withholding rates are applicable to certain dividends. The proposed Protocol provides a withholding tax rate of zero on dividends from certain 80-percent owned corporate subsidiaries as well as dividends paid to qualified pension funds. Under the existing Convention, direct dividends meeting a 10-percent ownership threshold are subject to a 5-percent maximum rate of withholding tax, and portfolio dividends are subject to a 10-percent maximum rate of withholding tax. These rates will continue to apply under the Convention as amended by the proposed Protocol.

This would be only the third U.S. income tax treaty to provide an exemption from withholding taxes for certain direct dividends—the others being the recent Income Tax Convention with the United Kingdom and the recent Protocol amending our Income Tax Convention with Australia, which are now pending before the Senate Foreign Relations Committee. Both the United States and Mexico share an understanding that the existing Income Tax Convention will be promptly amended if the United States concludes a treaty with a lower withholding rate on dividends with any other country. Therefore, ratification of the proposed Protocol is consistent with this understanding, given that we would simultaneously be seeking ratification of the U.K. and Australia treaties.

The maximum rates of withholding tax on dividends are subject to the standard anti-abuse rules for certain classes of investment

income found in other U.S. tax treaties and agreements. In addition, the withholding rates described above do not apply if the beneficial owner of the dividend is a resident of one Contracting State who carries on business in the other Contracting State and the income is attributable to a permanent establishment or fixed base situated in that other State. If the income is attributable to a permanent establishment, it will be taxed as business profits, and, if the income is attributable to a fixed base, it will be taxed as a payment for independent personal services.

The proposed Protocol brings the Convention into conformity with current U.S. tax treaty policy as to the treatment of dividends paid by U.S. regulated investment companies (RICs) and real estate investment trusts (REITs). The Protocol reflects a change in approach, adopted in 1997, which is intended to prevent the use of structures designed to avoid U.S. withholding tax on outbound dividends while providing appropriate benefits to portfolio investors in RICs and REITs.

The existing Convention preserves the U.S. right to tax former citizens whose loss of citizenship had, as one of its principal purposes, the avoidance of tax. Article I of the proposed Protocol expands this right to include former long-term residents whose loss of such status had, as one of its principal purposes, the avoidance of tax.

For purposes of applying rules regarding the elimination of double taxation, the proposed Protocol provides an updated provision regarding the source of income. Pursuant to Article V of the proposed Protocol, income that may be taxed by one of the parties to the Convention in accordance with the treaty will generally be treated as arising in that country. Thus, the other country will generally exempt that income from taxation or provide a credit for the taxes paid with respect to such income.

The United States and Mexico will notify each other, through diplomatic channels, when their respective constitutional and statutory requirements for entry into force have been satisfied. In accordance with Article VI, the proposed Protocol will enter into force on the date of receipt of the later of such notifications. The proposed Protocol will have effect, with respect to taxes withheld at source on dividends, for dividends paid or credited on or after the first day of the second month next following the date on which the proposed Protocol enters into force. The effective date for all other types of taxes is for taxable periods beginning on or after the first day of January of the year following the year in which the proposed Protocol enters into force.

The Department of the Treasury and the Department of State cooperated in the negotiation of the proposed Protocol. It has the full approval of both Departments.

Respectfully submitted.

COLIN L. POWELL.

SECOND ADDITIONAL PROTOCOL THAT MODIFIES THE CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE UNITED MEXICAN STATES FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME

The Government of the United States of America and the Government of the United Mexican States, desiring to amend the Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, along with a Protocol(the "Convention" and " Protocol", respectively), signed at Washington, D.C. on September 18, 1992; and

Having amended the Convention by an Additional Protocol that Modifies the Convention, signed at Mexico City on September 8, 1994;

Have agreed upon the following provisions which shall be an integral part of the Convention:

ARTICLE I

Article 1 of the Convention is deleted and the following Article is substituted:

"ARTICLE 1

General Scope

1. This Convention shall apply to persons who are residents of one or both of the Contracting States, except as otherwise provided in the Convention.

2. This Convention shall not restrict in any manner any exclusion, exemption, deduction, credit or other allowance now or hereafter accorded:

a) by the laws of either Contracting State; or

b) by any other agreement between the Contracting States.

3. Notwithstanding the provisions of subparagraph b) of paragraph 2:

a) any question arising as to the interpretation or application of this Convention and, in particular, whether a taxation measure is within the scope of this Convention, shall be determined exclusively in accordance with the provisions of Article 26 (Mutual Agreement Procedure) of this Convention; and

b) the provisions of any other agreement shall not apply to a taxation measure unless the competent authorities agree that the measure is not within the scope of Article 25 (Non-Discrimination) of this Convention.

For the purposes of this paragraph, a "measure" is a law, regulation, rule, procedure, decision, administrative action, or any similar provision or action.

4. Notwithstanding any provision of this Convention except paragraph 5, a Contracting State may tax its residents (as determined under Article 4 (Residence)), and by reason of citizenship may tax its citizens, as if the Convention had not come into effect.

5. The provisions of paragraph 4 shall not affect:

a) the benefits conferred by a Contracting State under paragraph 2 of Article 9 (Associated Enterprises), under subparagraph b) of paragraph 1 and paragraph 3 of Article 19 (Pensions, Annuities, Alimony, and Child Support), and under Articles 22

(Exempt Organizations), 24 (Relief from Double Taxation), 25 (Non-Discrimination), and 26 (Mutual Agreement Procedure); and

b) the benefits conferred by a Contracting State under Articles 20 (Government Service), 21 (Students), and 28 (Diplomatic Agents and Consular Officers), upon individuals who are neither citizens of, nor lawful permanent residents in, that State.

6. a) A former citizen or long-term resident whose loss of citizenship or long-term resident status had as one of its principal purposes the avoidance of tax (as defined under the laws of the Contracting State of which the person was a citizen or long-term resident) shall be treated for purposes of paragraph 4 of this Article as a citizen of that Contracting State, but only for a period of 10 years following the loss of such status. This paragraph shall apply only in respect of income from sources within that Contracting State (including income deemed under the domestic law of that State to arise from such sources).

b) The term "long-term resident" shall mean any individual who is a lawful permanent resident of a Contracting State in 8 or more taxable years during the preceding 15 taxable years. In determining whether the threshold in the preceding sentence is met, there shall not count any year in which the individual is treated as a resident of the other Contracting State under this Convention, or as a resident of any country other than the first-mentioned Contracting State under the provisions of any other tax treaty of that Contracting State, and, in either case, the individual does not waive the benefits of such treaty applicable to residents of the other country.

7. In the case of an individual who is a former citizen of a Contracting State, the following factors shall be considered favorably in determining whether or not one of the principal purposes of that individual's loss of citizenship of that Contracting State was the avoidance of tax:

a) at the time of the individual ceasing to be a citizen of that Contracting State or within a reasonable period thereafter, the individual is or becomes a resident fully liable to income tax in the other Contracting State, and

b) i) the individual was a citizen of both Contracting States at birth and has remained a citizen of the other Contracting State;

ii) at the time of the loss of such citizenship (or within a reasonable period thereafter), the individual was or became a citizen of the other Contracting State, and that other Contracting State was that individual's country of birth, or the country of birth of that individual's spouse or of either of that individual's parents;

iii) in the 10 years preceding the loss of such citizenship, the individual was present in that Contracting State for no more than 30 days in each taxable year or year of assessment; or

iv) the loss of citizenship occurred before the individual attained the age of 18 and one half years.

8. In the case of an individual who is a former long-term resident of a Contracting State, the following factors shall be considered favorably in determining whether or not one of the principal purposes of that individual's ceasing to be a long-term resident of that Contracting State was the avoidance of tax:

a) at the time of the individual ceasing to be a long-term resident of that Contracting State or within a reasonable period thereafter, the individual is or becomes a resident fully liable to income tax in the other Contracting State, and that other Contracting State is:

i) the country in which the individual was born;

ii) the country in which the individual's spouse was born; or

iii) the country where either of the individual's parents was born;

b) in the 10 years preceding the individual's ceasing to be a long-term resident of that Contracting State, the individual was present in that Contracting State for no more than 30 days in each taxable year or year of assessment; or

c) the individual ceases to be a long-term resident of that Contracting State before reaching the age of 18 and one half years."

ARTICLE II

a) Article 10 of the Convention is deleted and the following Article is substituted:

"ARTICLE 10

Dividends

1. Dividends paid by a company which is a resident of one of the Contracting States to a resident of the other Contracting State may be taxed in that other State.

2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident, and according to the law of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

a) 5 percent of the gross amount of the dividends, if the beneficial owner is a company which owns directly at least 10 percent of the voting stock of the company paying the dividends; and

b) 10 percent of the gross amount of the dividends in all other cases.

This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

3. Notwithstanding the provisions of paragraph 2, dividends shall not be taxed in the Contracting State of which the company paying the dividends is a resident if the beneficial owner is a resident of the other Contracting State and is either:

a) a company that has owned shares representing 80 percent or more of the voting stock of the company paying the dividends for a 12-month period ending on the date the dividend is declared, and that:

i) prior to October 1, 1998 owned, directly or indirectly, shares representing 80 percent or more of the voting stock of the company paying the dividends; or

ii) is entitled to the benefits of the Convention under clauses (i) or (ii) of subparagraph d) of paragraph 1 of Article 17 (Limitation on Benefits); or

iii) is entitled to the benefits of the Convention with respect to the dividends under subparagraph g) of paragraph 1 of Article 17; or

iv) has received a determination from the relevant competent authority pursuant to paragraph 2 of Article 17 with respect to this paragraph; or

b) a trust, company, or other organization constituted and operated exclusively to administer or provide benefits under one or more plans established to provide pension, retirement or other employee benefits and its income is generally exempt from tax in the Contracting State of which it is a resident, provided that such dividends are not derived from the carrying on of a business, directly or indirectly, by such trust, company or organization.

4. a) Subparagraph a) of paragraph 2 and subparagraph a) of paragraph 3 shall not apply in the case of dividends paid by a Regulated Investment Company (RIC) or a Real Estate Investment Trust (REIT).

b) In the case of dividends paid by a RIC, subparagraph b) of paragraph 2 and subparagraph b) of paragraph 3 shall apply.

c) In the case of dividends paid by a REIT, subparagraph b) of paragraph 2 and subparagraph b) of paragraph 3 shall apply only if:

i) the person beneficially entitled to the dividends is an individual or a person described in subparagraph b) of paragraph 3, in either case owning an interest of not more than 10 percent in the REIT;

ii) the dividends are paid with respect to a class of stock that is publicly traded and the person beneficially entitled to the dividends owns an interest of not more than 5 percent of any class of the REIT's stock; or

iii) the person beneficially entitled to the dividends owns an interest of not more than 10 percent in the REIT and the gross value of no single interest in real property held by the REIT exceeds 10 percent of the gross value of the REIT's total interest in real property.

5. The provisions of paragraphs 1, 2, 3 and 4 of this Article shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, carries on or has carried on business in the other Contracting State, of which the company paying the dividends is a resident, through a permanent establishment situated in that other Contracting State, or performs or has performed in that other Contracting State independent personal services from a fixed base situated in that other State, and the dividends are attributable to such permanent establishment or fixed base. In such case the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, shall apply.

6. The term "dividends" as used in this Article means income from shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights that is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.

7. When a company that is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by a company which is not a resident of that State, except insofar as such dividends are paid to a resident of that other State or the dividends are attributable to a permanent establishment or fixed base situated in that State.

8. The competent authorities of the Contracting States shall consult each other with a view to develop a commonly agreed application of clause iv) of subparagraph a) of paragraph 3 of this Article, including the publication of regulations or other public guidance."

b) Paragraph 8 of the Protocol is deleted and the following is substituted:

"8. With reference to paragraph 3 of Article 10 (Dividends).

If the United States agrees in a treaty with another country to a provision similar to paragraph 3 of Article 10 of the Convention, but with more beneficial conditions than those contained in paragraph 3 of Article 10, the Contracting States shall, at Mexico's request, consult each other with a view to concluding an additional protocol to incorporate similar provisions into paragraph 3 of Article 10 to restore the balance of the benefits provided under the Convention."

c) With regard to paragraph 9 of the Protocol, the reference to "paragraph 4 of Article 10 (Dividends)," is deleted and substituted by "paragraph 6 of Article 10 (Dividends),".

ARTICLE III

Article 11A of the Convention is amended by inserting an additional paragraph as follows:

"3. Notwithstanding the provisions of the preceding paragraphs, a company will be exempt from the tax described in subparagraph a) of paragraph 2 if such company:

a) prior to October 1, 1998, was engaged in activities giving rise to profits attributable to the permanent establishment described in paragraph 2 or to income or gains to which the provisions of Article 6 (Income From Immovable Property (Real Property)) or, as the case may be, paragraphs 1 and 4 of Article 13 (Capital Gains) apply;

b) is entitled to the benefits of the Convention under clauses (i) or (ii) of subparagraph d) of paragraph 1 of Article 17 (Limitation on Benefits);

c) is entitled to the benefits of the Convention with respect to the dividends under subparagraph g) of paragraph 1 of Article 17; or

d) has received a determination from the relevant competent authority pursuant to paragraph 2 of Article 17 with respect to this paragraph."

ARTICLE IV

Paragraph 4 of Article 13 (Capital Gains) of the Convention is deleted and the following paragraph is substituted:

"4. In addition to gains taxable in accordance with the provisions of the preceding paragraphs of this Article, gains derived by a resident of a Contracting State from the alienation of stock, participation, or other rights in the capital of a company or other legal person which is a resident of the other Contracting State may be taxed in that other Contracting State if the recipient of the gain, during the 12-month period preceding such alienation, had a participation,

directly or indirectly, of at least 25 percent in the capital of that company or other legal person."

ARTICLE V

Paragraph 3 of Article 24 (Relief From Double Taxation) of the Convention is deleted and the following is substituted:

"3. For the purposes of allowing relief from double taxation pursuant to this Article, an item of gross income, as determined under the laws of a Contracting State, derived by a resident of that State that under this Convention may be taxed in the other Contracting State (other than solely by reason of citizenship in accordance with paragraph 4 of Article 1 (General Scope)), shall be deemed to be income from sources in that other State."

ARTICLE VI

a) The Contracting States shall notify each other, through diplomatic channels, when their respective constitutional and statutory requirements for the entry into force of this Protocol have been satisfied. This Protocol shall enter into force on the date of receipt of the later of such notifications.

b) The provisions of this Protocol shall have effect:

i) in respect of Article II, for dividends paid or credited on or after the first day of the second month next following the date on which the Protocol enters into force;

ii) in respect of Articles I, III, IV and V, for taxable periods beginning on or after the first day of January of the year following the year in which the Protocol enters into force.

ARTICLE VII

This Protocol shall remain in force as long as the Convention and Protocol of September 18, 1992, remain in force.

IN WITNESS WHEREOF, the undersigned, being duly authorized thereto by their respective Governments, have signed this Protocol.

DONE at Mexico City, on the 26th day of November, 2002, in duplicate, in the English and Spanish languages, both texts being equally authentic.

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA:

FOR THE GOVERNMENT OF THE UNITED MEXICAN STATES:

O