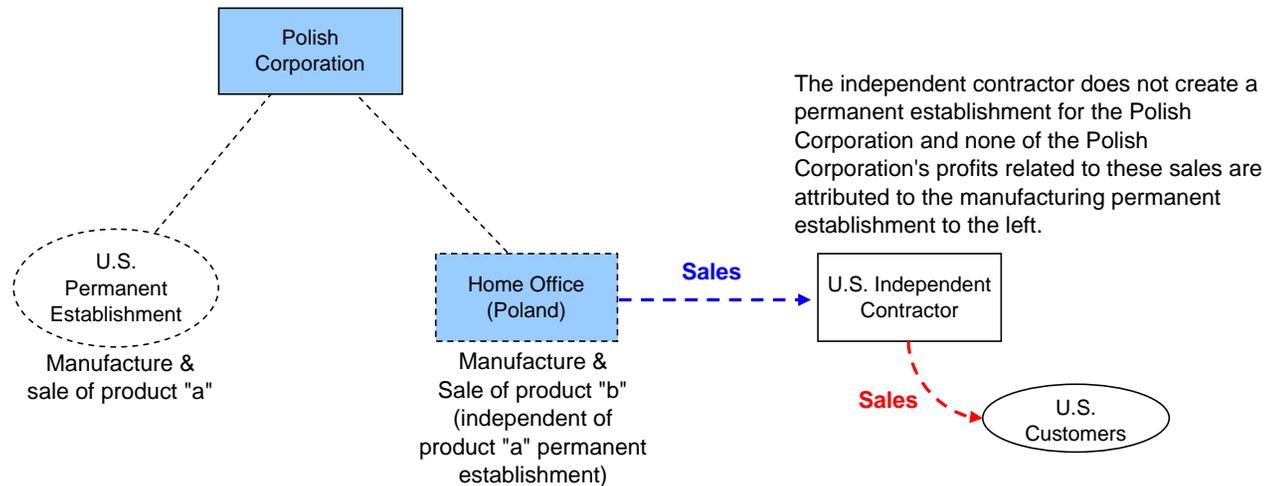


Profits Not Attributable to a U.S. Permanent Establishment



The concept of taxing profits attributable to a permanent establishment in the U.S. in the context of a tax treaty is analogous to the concept of taxing income effectively connected with conduct of a trade or business embodied in section 864(c). The "effectively connected" principle was introduced by the Foreign Investors Tax Act of 1966, for purposes of the differentiation in tax treatment between business and nonbusiness (investment) income. Progressive or corporate rates were imposed on the former and a flat 30% rate was imposed on the latter.

Prior to the introduction of this principle, U.S. source income of foreign persons or entities was taxed under what is referred to as the "force of attraction" principle. Under this principle, all U.S. source income was treated as taxable at progressive or corporate rates if the foreign person or entity was engaged in trade or business in the U.S. A limited form of this "force of attraction" principle has been retained in section 864(c)(3). This section and the regulations thereunder provide that any U.S. source income of a foreign taxpayer that is not fixed or determinable within the meaning of section 871(a)(1) shall be treated as effectively connected with the conduct of a taxpayer's trade or business within the U.S. The question arises, therefore, whether the "attributable to" principle of taxation applied in the context of the Polish Convention should be interpreted similarly to its analogue, the "effectively connected" principle applied in the Code.

The Code specifically retains a limited or residual "force of attraction" principle as discussed above without any indication that it shall apply to any tax treaties. There is no indication of the application of this residual principle, specifically or otherwise, in the Polish Convention. Although there are many areas in which the "attributable to" and "effectively connected" principles overlap, these principles are only analogous. They are not synonymous. The "attributable to" principle is limited in its scope, which does not encompass the residual "force of attraction" principle present in section 864(c)(3). The Technical Explanation of the Convention prepared by the Department of the Treasury in discussing Article 8 of the Convention states, "While this Convention does not contain an explicit definition of the term 'effectively connected,' that term has substantially the same meaning as in section 864(c)(2)"