Recent Developments in International Taxation

Seminar J

Introduction

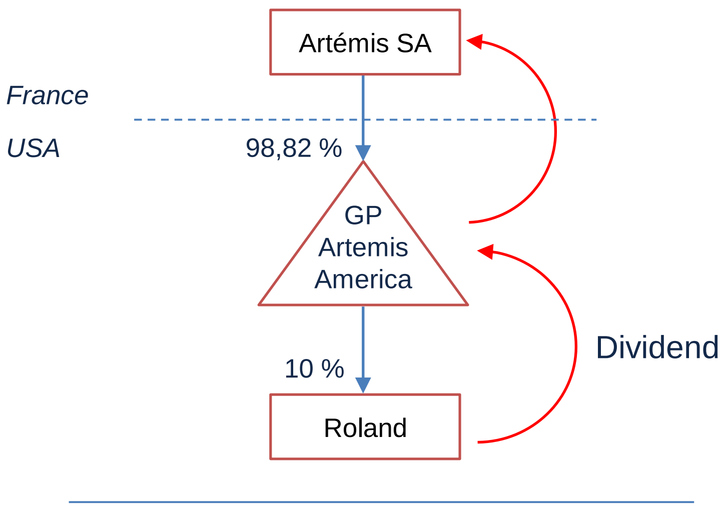
Speakers

- Herman B. Bouma (USA)
- Luzius Cavelti (Switzerland) (secretary)
- Jean-Blaise Eckert (Switzerland)
- Daniel Gutmann (France) (chair)
- John Lorito (Canada)
- Porus Kaka (India)
- Arne Schnitger (Germany)
- John Taylor (Australia)
- Mike Williams (United Kingdom)
- Bartjan Zoetmulder (Netherlands)

Partnerships and Tax Treaties

French Case – Classification of Foreign Partnerships

- **The « Artémis » case : French Supreme Court (Conseil d'Etat), 24 Nov. 2014**



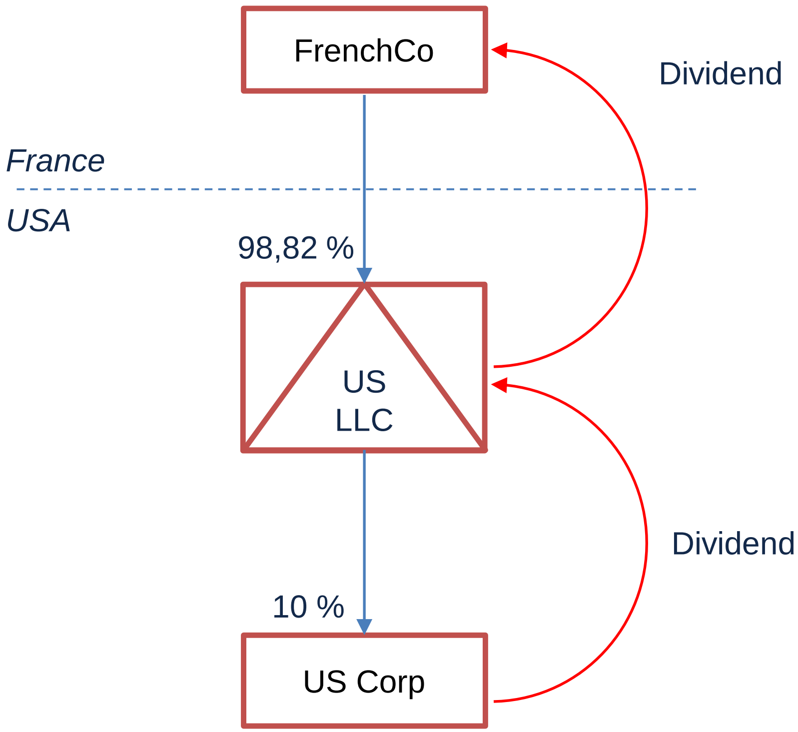
Principle

- *« The tax judge must identify, in the light of all the characteristics of the [non-resident] company and of the law which governs its establishment and its operation, the kind of French law company to which the foreign law company may be compared »*
- Legal characterization rather than tax characterization (transparent or opaque) is relevant to classify the foreign entity for French tax purposes
- The fact that the GP is transparent for US tax purposes has therefore no impact on the reasoning

Applications

- A US *General Partnership* is compared to a French SNC (« société en nom collectif ») because it enjoys legal personality and the partners' liability is unlimited
- A SNC enjoys legal and tax personality although its profits are taxed at the level of the partners
- The participation exemption regime (exemption of the dividends) is therefore not applicable

Slightly Modified Case : What would the Judge Decide if the Intermediate Company was a LLC?



Legal characterization of the *Limited Liability Partnership* (LLC)

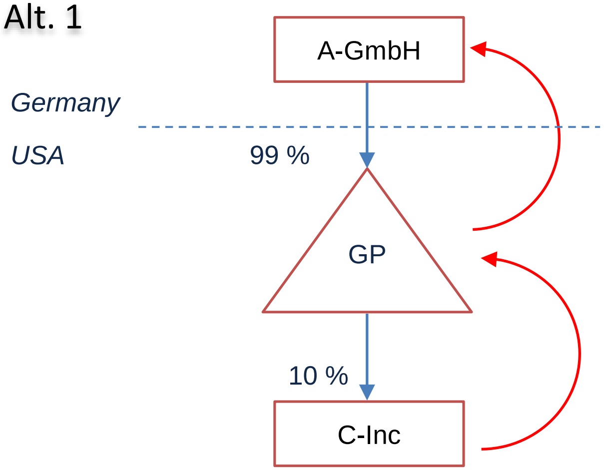
- Partners of the LLC have limited liability
- LLC should be compared to a French limited liability company => LLC should be treated as an opaque entity for tax purposes

Tax treatment

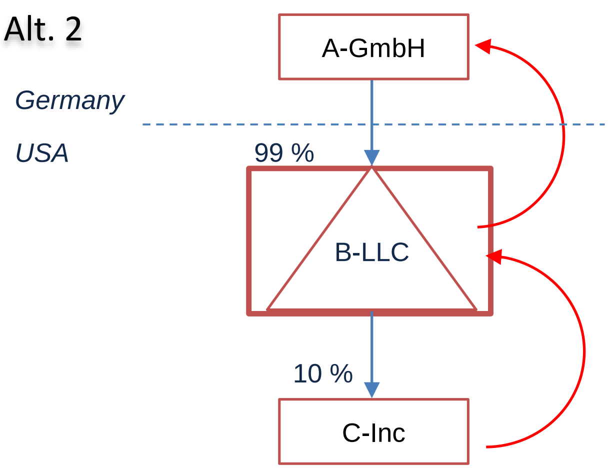
- Dividends paid by US Corp to US LLC should not suffer any taxation in France
- Dividends distributed by US LLC :
  - Are not taxed under US tax law
  - Should enjoy participation exemption under French tax law

What is the German Approach (Artémis Case)?

Alt. 1



Alt. 2



Principles

- Tax characterization (transparent or opaque) depends on certain legal criteria (such as e.g. transferability of shares and liability)

Alt. 1

- A-GmbH is taxed with regard to dividend distribution of C-Inc.
- No application of dividend exemption under DTT as GP owns legally the shares in C-Inc.
- Dividend exemption under national law for corporate income tax purposes applies

Alt. 2

- A-GmbH is taxed with regard to dividend distribution of B-LLC.
- No application of dividend exemption under DTT as B-LLC is not tax-resident.
- Dividend exemption under national law for corporate income tax purposes applies

What is the Canadian Approach?

- Canada applies its tax rules using the same approach that the partners do not have an ownership interest in the assets of the partnership

- As a result, previously under the Canadian foreign affiliate rules a foreign corporation owned by a Canadian corporation through a partnership would not be a foreign affiliate with the result that dividends from the foreign corporation were fully taxable in Canada.

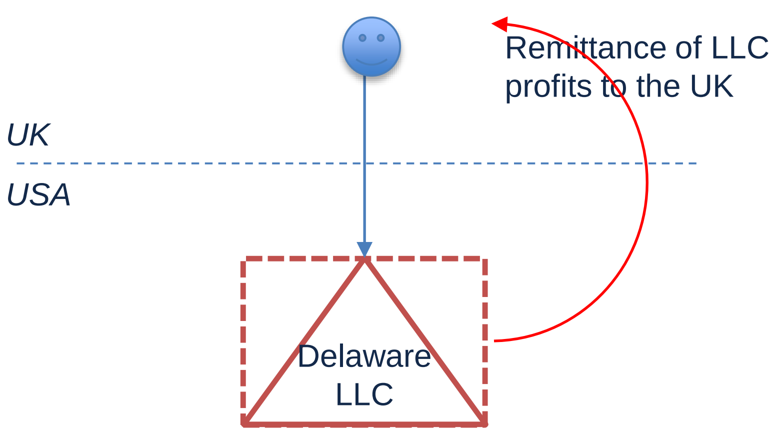
- Changes to the Canadian foreign affiliate rules created deemed ownership provisions to allow foreign affiliate status for foreign corporations owned through partnerships.

- Same issues arises under Canadian treaties.

- Any treaty entitlements that requires ownership of shares or voting power will not be granted if the shares or voting power are owned through a partnership.

Compare with the UK Approach in Anson

- **The « Anson » case : UK Supreme Court, 1 July 2015**



Factual pattern

- Mr. Anson is resident but non domiciled in the UK
- The profit (after US tax) of a Delaware LLC of which he is a member is remitted to the UK
- Mr. Anson claims tax credit // US tax charged to him. HMRC refuses the claim on the basis that the LLC is a taxable entity
- The (fact-finding) tribunal decided that 'The profits do not belong to the LLC in the first instance and then become the property of the members'

Judgment

- The members of the LLC have an interest in the profits of the LLC as they arise
- Mr. Anson qualifies for double taxation relief under Art. 23 (2) (a) of the UK/US Treaty

What is the Canadian Approach?

- Canada treats the LLC as opaque i.e. as a corporation. As a result, Canadian tax is paid on the distributions from the LLC whereas the U.S. tax is paid on the business profits of the LLC.

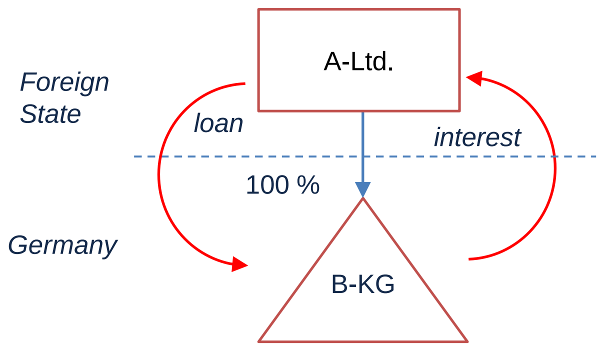
- In a technical interpretation the Canadian tax authorities stated that they would not provide a full foreign tax credit to an individual in respect of the foreign taxes paid on the income earned through a LLC.

- The reason is that the source as seen for Canadian purposes is the shares of the LLC whereas the source of the income for U.S. tax purposes is seen as the buiness profits of the LLC.

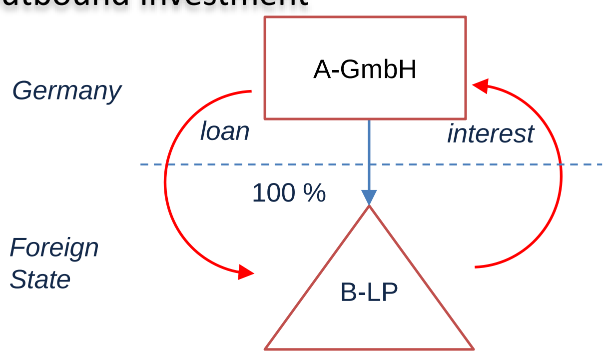
- The Canadian tax authorities have not considered the possible application of article 24 of the Canada-US double taxation treaty, which provides that double tax relief should be provided in these circumstances if the Canadian tax payable is in respect of the same profits on which the U.S. tax is payable.

Taxation of Interest from Shareholder Loans

Inbound Investment



Outbound Investment



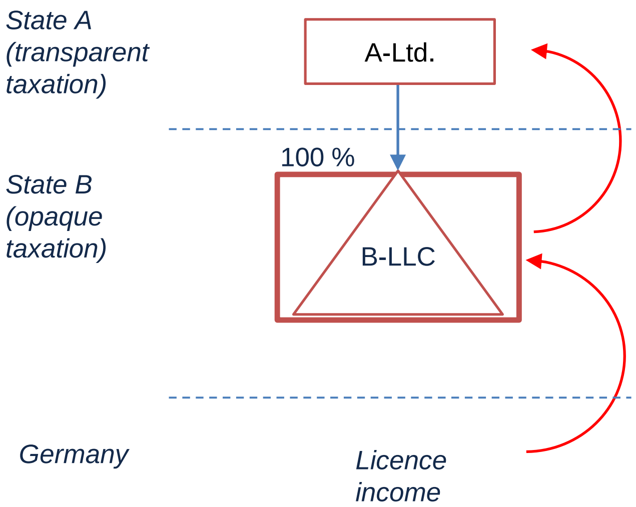
Inbound Investment

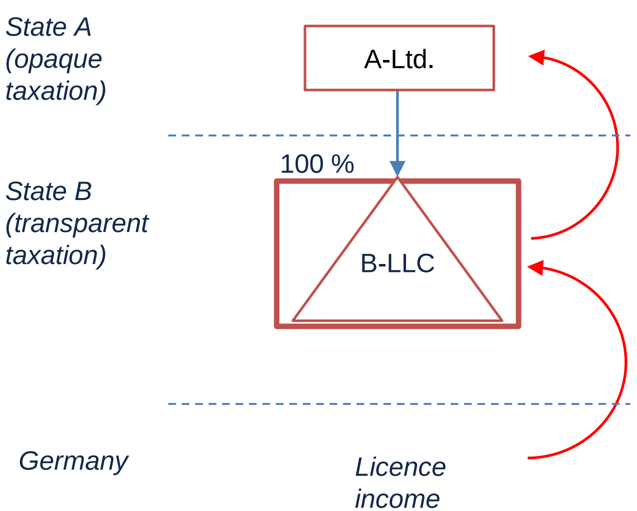
- Interest income of A-Ltd. is characterized as business income for treaty purposes
- Deemed allocation of interest income to P.E. of B-KG for treaty purposes
- Treaty Override
- Germany credits foreign taxes (on CIT) if foreign state does not credit German taxes

Outbound Investment

- Interest income of A-GmbH is characterized as business income for treaty purposes
- Deemed allocation of interest income to P.E. of B-LP for treaty purposes
- Domestic switch-over clause
- But: Limited taxing right of foreign state under Art. 11 DTT Germany sufficient (Federal Tax Court dated 20.5.2015, I R 69/14; dated 11.1.2012, I R 27/11)

Treaty Entitlement and Partnerships





Facts

- License income is taxed at the level of B-LLC in State B
- License income is taxed at the level of A-Ltd. in State A

OECD

- DTT Germany/State B and DTT Germany/State A apply

German Ministry of Finance (dated 26.9.2014)

- Only DTT Germany/State B applies

Facts

- License income is not taxed at the level of A-Ltd (income is « blocked »)
- License income is not taxed at the level of B-LLC

OECD

- No DTT application

German Ministry of Finance (dated 26.9.2014)

- DTT Germany/State A applies

Diverted Profits Tax (DPT)

Context behind introduction of the DPT

- Strong UK government commitment to combatting tax avoidance, evasion and aggressive tax planning
  - The public see practices such as aggressive tax planning as unfair and unacceptable
  - Bringing the deficit down requires tough decisions, with everyone paying their fair share of tax
- Particular public concern with aggressive tax planning by some multinationals
- The DPT
  - Is targeted at contrived and artificial tax arrangements employed by multinational groups
  - Reflects the objective to ensure that profits are taxed in the UK when the economic activities that give rise to them take place in the UK
- Consistent with the OECD-G20 base erosion and profit shifting (BEPS) project
  - Essentially the same objective
  - Not appropriate to delay tackling contrived and artificial arrangements that some other participant countries already had legal provision to tackle
- A single coherent message, in two parts
  - Come to the UK, and invest in the UK
  - Pay tax on the profits, at a very competitive rate
    - 20% corporation tax rate from 1 April 2015
    - 19% from 1 April 2017
    - 18% from 1 April 2020

Main features of the DPT (1)

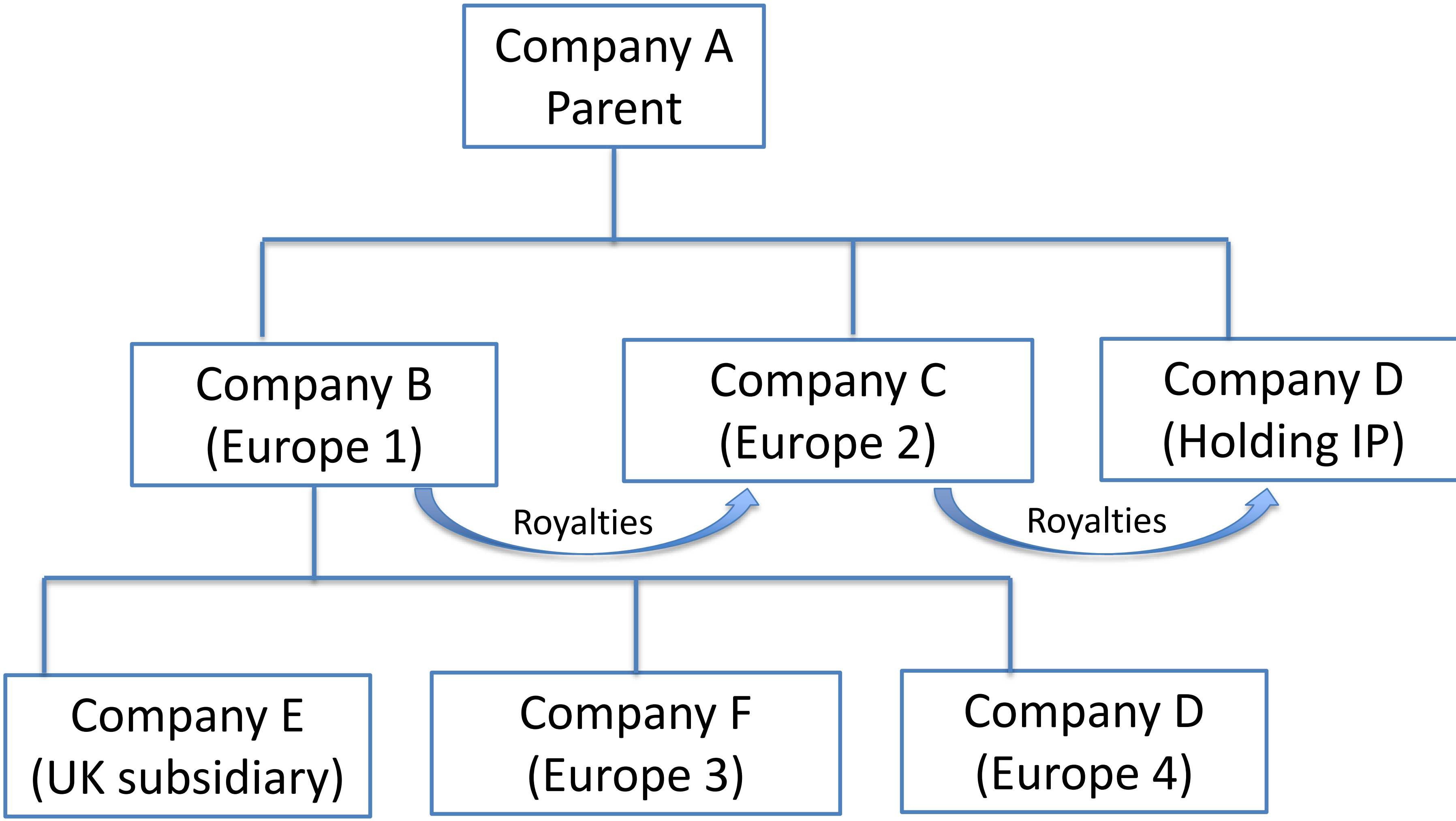
- A separate tax, legislated in Finance Act 2015
- Applies from 1 April 2015, at a 25% rate
- Targeted on
  - Contrived or artificial arrangements designed to avoid a permanent establishment arising (s86)
  - Transactions that erode the UK tax base and lack economic substance – recharacterised (s80, 81)
- In terms of structure, very broadly
  - s80 applies to UK resident companies
  - s81 applies to non-UK resident companies with PEs
  - s86 applies to non-UK resident companies without PEs, and covers the s81 ground where it deems a PE
- Exclusions for
  - Loan relationships (broadly, transactions generating interest payments)
  - Small and medium-sized enterprises
  - De minimis cases
- UK relief for double (UK and foreign) taxation provided
- Administrative mechanics
  - The taxpayer has to notify potential liability (s92)
  - If a charging notice is issued by HMRC, the tax must be paid within 30 days
  - Tax has to be paid pending an appeal, but is repaid with interest if the appeal succeeds

Main features of the DPT (2)

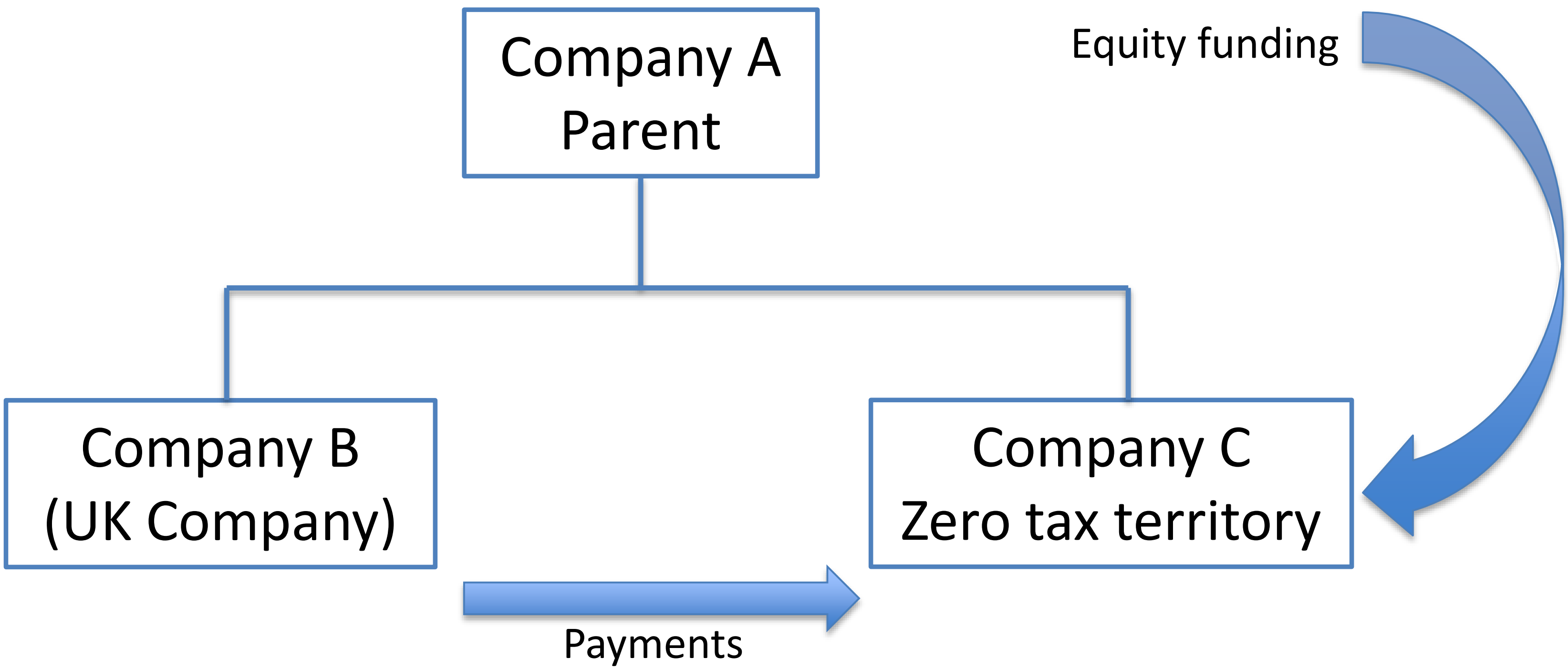
- Recharacterisation cases (s80, 81)
  - Trigger is “effective tax mismatch outcome” <u>and</u> “insufficient economic substance” (s80)
  - “Effective tax mismatch outcome” (s107) is an 80% test (against a 20% main rate)
  - “Insufficient economic substance” (s110) effectively weights tax advantages against non-tax benefits
  - Counteraction based on “just and reasonable alternative provision” (s82-85)

- PE cases (s86)
  - Triggers are “mismatch condition” (s86(2)) and/or “tax avoidance condition” (s86(3))
  - “Mismatch condition” is the same as the s80,81 trigger
  - “Tax avoidance condition” is a less novel “one of the main purposes” test
  - Counteraction differs because the circumstances reflected in the conditions are different
    - If just the “Tax avoidance condition” is in point, then effectively a PE is deemed and the usual rules apply (s88, 89)
    - If the “mismatch condition” is triggered, then a PE is deemed and the s80, 81 rules are mirrored (s88, 90, 91)

Example – Avoiding a UK taxable presence



Example - Recharacterisation

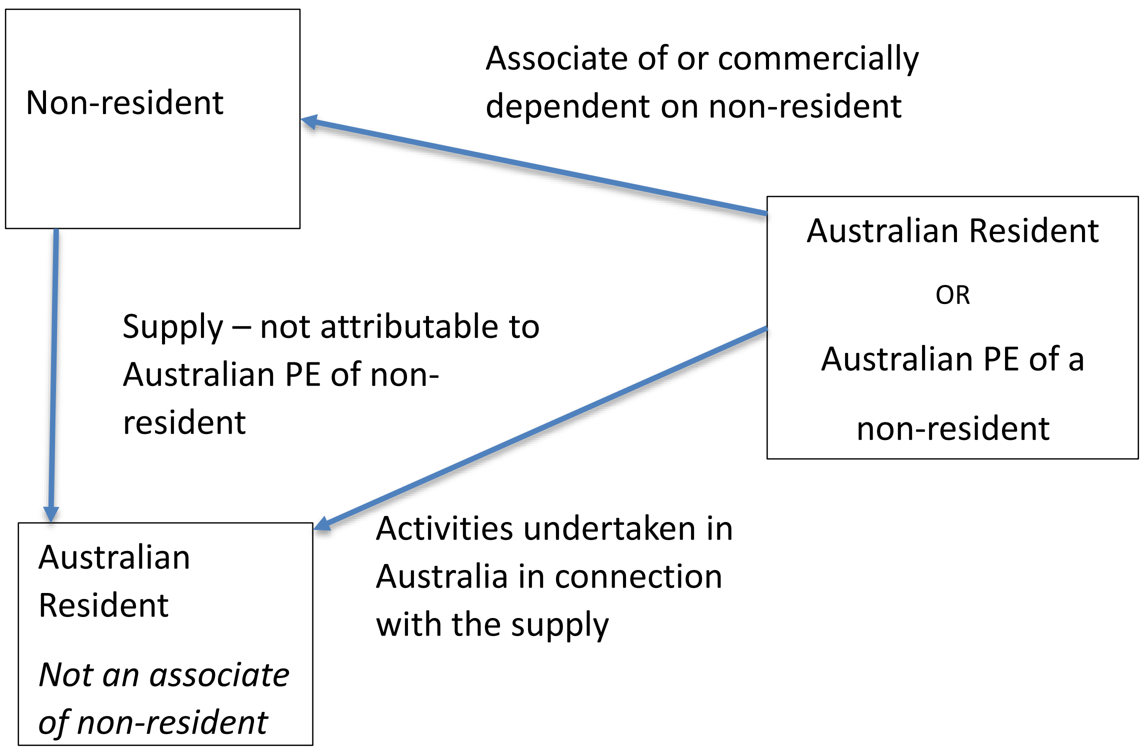


Compatibility with the UK‘s international obligations

- Clearly recognised upfront as a core requirement in designing the DPT
- Three aspects
    - The UK‘s existing tax treaties
    - The fundamental freedoms enshrined in the EU treaty
    - The European Convention on Human Rights (ECnHR)
- The UK‘s existing tax treaties
    - Treaties are not self-executing in UK law
    - Section 6, TIOPA 2010 gives effect to tax treaties as regards income tax, corporation tax, capital gains tax and petroleum revenue tax (but DPT is not corporation tax)
    - Model tax convention allows adoption of domestic anti-abuse measures
- The fundamental freedoms
    - Primarily about freedom of establishment
    - Freedom to establish for genuine commercial purposes
    - Is the freedom restricted by the DPT?
    - Is there a justification for any such restriction (if found)?
    - A proportionate response to aggressive tax planning
- ECnHR
    - Challenge very difficult to sustain given ECtHR and UK jurisprudence

Australia: Trying To Achieve Similar Results Through Different Techniques

Exposure Draft May 2015 -Tax Integrity Multinational Anti Avoidance Law –
Basic requirement s177DA(1)(a)



Australia: Trying To Achieve Similar Results Through Different Techniques

Additional requirements and consequences

- s177DA(1)(b) – must be reasonable to conclude that scheme is 'designed to avoid **the non-resident** deriving income from the s177DA(1)(a) supplies that would be attributable to an Australian PE of the non-resident
- s177DA(1)(c) – it would be concluded that the person or one of the persons who entered into or carried out the scheme did so for **a principal purpose** or for more than one principal purpose of enabling **a taxpayer** (the relevant taxpayer) or the relevant taxpayer and one or more other taxpayers to obtain **a tax benefit** or to obtain a tax benefit and reduce other Australian and/or foreign tax liabilities
- s177DA(1)(d) – non-resident's annual global revenue (or annual global revenue of consolidated group of which non-resident is a member) >$AUD1billion
- s177DA(1)(e) – **the non resident** is connected with a no or low tax jurisdiction
- Where s177DA applies – GAAR is triggered and Commissioner can (for example) include amounts in assessable income of the taxpayer who obtained the tax benefit
- International Tax Agreements Act 1953 says that tax treaties prevail over inconsistent domestic law other than the GAAR

Observations on the UK and Australian Rules

- To what extent does DPT affect tax planning?

  Four possibilities:

  (1) The anti-India approach: Disinvest from, or slow down investment in, the United Kingdom. (The United Kingdom no longer appears open for business.)

  (2) The Amazon approach: Reorganize to make sure there is no problem.

  (3) The middle approach: Slightly reorganize to reduce exposure.

  (4) The do-nothing approach: Do nothing and fight it out on audit, perhaps challenging the validity of the legislation (particularly the non-applicability of income tax treaties?).

- Issues relating to treaty override

Pending Case in India - On the “MAT”

- What is MAT?

- Introduced initially to levy a minimum alternate tax on companies paying less or no taxes despite earning book profit and declaring dividends

- MAT levied on book profit that was disclosed to shareholders

Chronological History

- Empirical evidence in history of provisions to show it was intended, for ‘zero tax’ yet high dividend domestic companies
- Conflicting ruling of AAR in Praxair, Timkin, Castleton, ZD, etc.
- Early 2015 application of MAT across the board to FII’s
- Estimates of amount involved in dispute range from $ 95 million to $ 500 million

Chronological History (cont'd)

- May 2015 - Government immediately stepping in and amending law for future

- June 2015 - AP Shah Commission formed to advise on the issue has submitted its report to the Finance Ministry in India on 24th July 2015

- Castleton pending in the Supreme Court of India and Aberdeen pending in Bombay HC

Indian Case on Minimum Alternative Tax

From Minimum Alternate Tax to Minimum Tax

Indian Case on Minimum Alternative Tax

Retrospective amendments

to be or **NOT** to be..

That is not the question

AP Shah committee recommends MAT relief for Foreign Portfolio Investors.

2nd Sept 2015-Government to accept the Shah panel report with "***retrospective effect in favour of Taxpayers*".**

Disclosure of Foreign Assets

The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax) ACT, 2015

- Act provides for separate taxation of any undisclosed income in relation in relation to foreign income and assets
- The Act to apply to all person resident in India
- Apply to both undisclosed foreign income and assets including financial interest in any entity.
- Taxed at flat rate of 30 percent without any exemptions or deductions or set off of any carried forward losses which may be admissible under the Income Tax Act, 1961
- Penalty will be equal to three times the amount of tax payable (90 %) including the tax payable (30%)
- Failure to furnish or disclose in the return in respect of foreign income or assets shall attract a penalty of 10 lakhs or above

Contributions to IFA wholly deductible !!!

CIT v. Vaish Associates, ITA 50/2014 (Del HC) dt. 11-8-2015

- HC affirmed ITAT view that contribution made by the Assessee to the Indian branch of the IFA, would create greater awareness of the Assessee firm and therefore deductible for its business purposes
- ITAT held:
  - IFA to be a professional body and a non-profit organisation engaged in the study of international tax laws and policies
  - Further, since the Indian branch of IFA was a non-profit organisation registered under Section 12 AA of the Act, its income was not taxable and the question of deduction of tax at source from the payment made to it

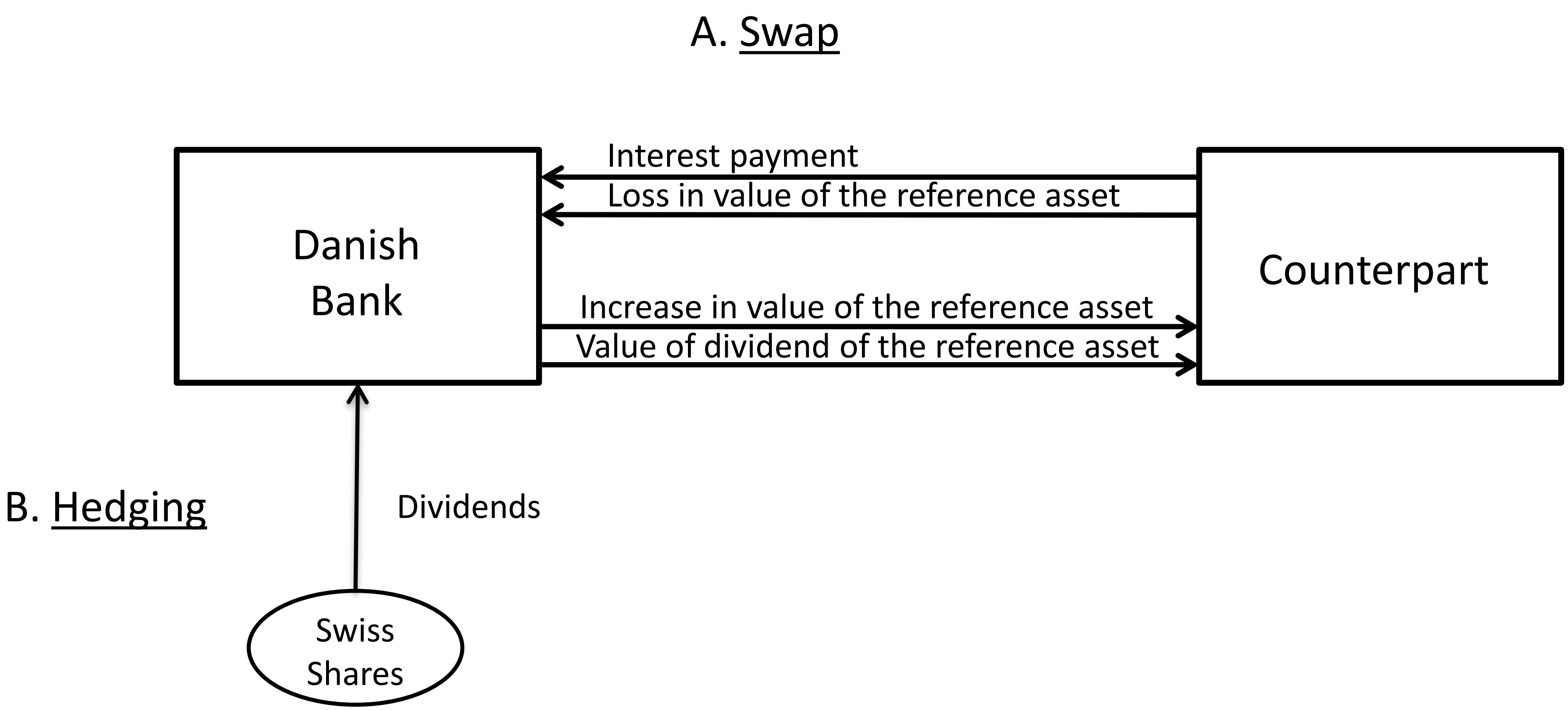
Coffee Break

Beneficial Ownership

Swiss Case on Total Return Swaps

- The Danish Bank (A. A/S) Case: Swiss Federal Supreme Court, public deliberations of May 5, 2015 (no written decision yet).

Do Total Return Swaps prevent any beneficial ownership?



Swiss Case on Total Return Swaps

Questions analyzed by the Swiss Federal Supreme Court

1. Is the beneficial ownership clause implicit in a DTT?

    - DTT CH-DK (1973) only refers to residence
    - Reference to the evolving Commentary and reference to scholars

Finding: Beneficial ownership constitutes a requirement to obtain treaty benefits, regardless of the text of the DTT.

Swiss Case on Total Return Swaps

Questions analyzed by the Swiss Federal Supreme Court

2. Is the Bank the beneficial owner of the dividends?

The Swiss Federal Supreme Court held:

- Beneficial ownership refers to property and economic control, although not in a strict technical and formal understanding (Vogel).
- A holistic, economic approach is necessary. It allows taking into account all facts, including future dividends received by the Bank. This applies even though courts may not take an *ex-post* view.
- *De facto* double interdependence is the test.
- There is a "factual obligation" from the Bank to remit the dividends to the Counterpart. The receipt of the dividend is a consequence of the swap transaction. No risk on the "flow of dividends".
- There is a full and contemporaneous hedging.
- Hedging is an evidence that the Bank does not want to take any risk (!)

Finding: no beneficial ownership is recognized.

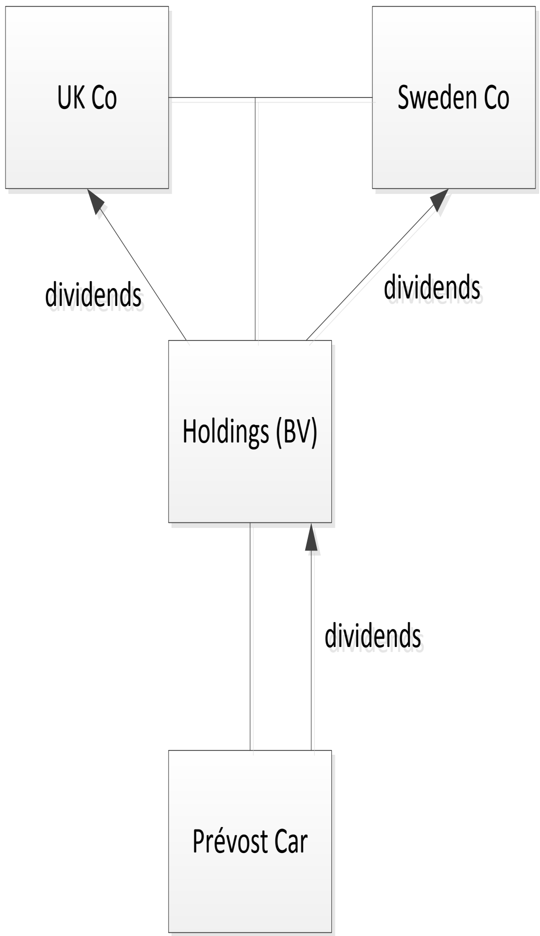
Swiss Case on Total Return Swaps

Observations :

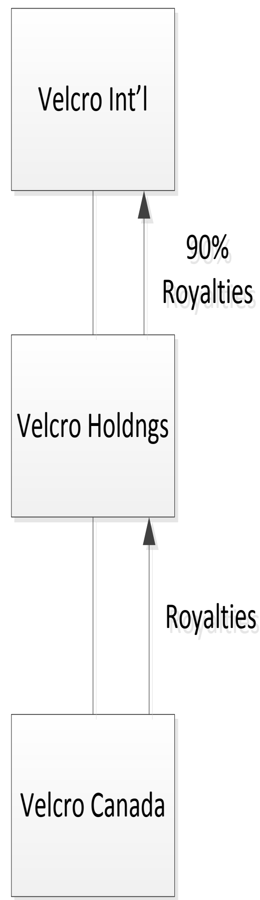
- Over use of the *de facto* analysis.
- Absence of risk should be irrelevant in the banking industry.
- No view on the business itself (it is the very business of a bank to hedge its positions, and to generate margins only).
- Compare this with the 2014 OECD Commentary on beneficial ownership (para. 12 (4) on article 10).

Canadian Approach to Beneficial Ownership

Prévost Car



Velcro



- There have been two Canadian cases dealing with the meaning of "beneficial ownership" as that term is used in Canada's treaties: *Prévost Car* and *Velcro*
- *Prévost* dealt with dividends paid by a Canadian corporation (Prévost) to a Dutch holding company (Holdings) that had one UK resident shareholder and one Swedish resident shareholder
- *Velcro* dealt with the payment of royalties
- A Dutch company (Velcro Holdings) received royalties from a Canadian corporation (Velcro Canada) and was required to pay 90 per cent of the royalties to a related corporation resident in the Dutch Antilles (Velcro International)
- The main difference between *Velcro* and *Prévost* was the existence in *Velcro* of a contractual obligation on Velcro Holdings to pay 90 per cent of the royalties to Velcro International
- In both cases the Courts applied a fairly narrow domestic meaning to the term beneficial owner and found that the recipient of the dividends and royalties paid by the Canadian residents was the beneficial owner of the dividends and royalties, respectively

Canadian Approach to Beneficial Ownership and Total Return Swaps

- The Canadian courts identified four elements that must be considered in determining beneficial ownership: possession, use, risk and control

- A person may possess all of these elements in respect of an amount received even though it has a contractual obligation to pay all or a portion of that amount to a third party

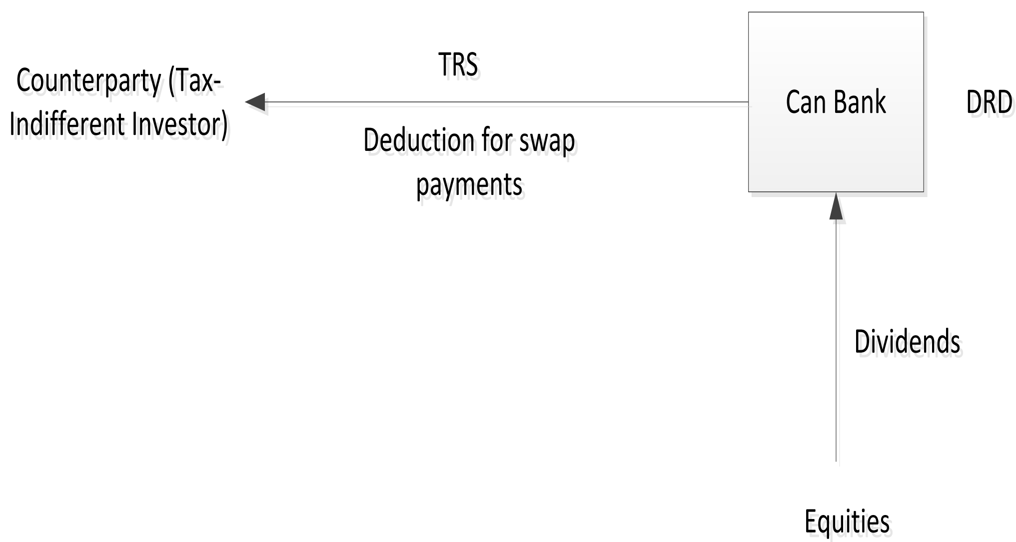
- The Courts also noted that it must be determined that the recipient is not a mere agent, nominee or conduit.

- The Courts were of the view that a person is only a conduit if that person has no discretion with respect to the use of the funds received

- In Velcro, the Court cited the following criteria in support of its findings:
  - the funds of Velcro Holdings were not segregated
  - the royalty payments from Velcro Canada to Velcro Holdings and from Velcro Holdings to Velcro International were different amounts
  - there was no pre-determined flow of funds

- While the Canadian courts have not been asked to consider the application of the concept of beneficial ownership to a total return swap in the context of the facts in the Swiss case, based on the principles applied by the Canadian courts it seems unlikely that a similar result would be reached

Alternative Approach to TRS



- Canada has adopted an alternative legislative approach to total return swaps
- New rules have been proposed to apply to a situation in which a Canadian financial institution enters into a total return swap with a non-resident counterparty in respect of Canadian equities
- In the absence of the new rules, the tax result of this situation would generally be as follows:
- The Canadian financial institution receives dividends on the Canadian equities tax-free by virtue of the Canadian dividend received deduction
- The Canadian financial institution obtains a deduction in respect of its liability to make payments under the swap
- Generally, there would be no withholding tax on the swap payments to the non-resident counterparty, subject to the possible application of the Canadian general anti-avoidance rule
- In effect, the Canadian financial institution obtains a net deduction for the payments made under the TRS. This net deduction is available to shelter income from other activities

Alternative Approach to TRS

- The new rules introduced on April 21, 2015 alter the first tax consequence by denying the dividend received deduction for certain dividends received pursuant to a "synthetic equity arrangement" (SEA)

- A SEA is generally an agreement or arrangement in respect of a share of a corporation of a person that has the effect of providing to another person all or a portion of the risk of loss or opportunity for gain or profit in respect of the share. For greater certainty, opportunity for gain or profit includes rights to, benefits from and distributions on a share

- The dividend received deduction is not denied even if the recipient has entered into an SEA in respect of the share if the recipient establishes that no tax-indifferent investor has all or substantially all of the risk of loss and opportunity for gain or profit in respect of the share because of the SEA

- A tax-indifferent investor includes an investor that is exempt from Canadian tax and a non-resident person other than a person to which all amounts paid or credited under a SEA may reasonably be attributed to the business carried on by the person in Canada through a permanent establishment

Alternative Approach to TRS

- As noted, the Canadian approach affects only the financial institution's ability to claim a deduction for the dividend received with the result that, if the new rules applies, the financial institution would have an income inclusion in respect of the dividend received and a deduction in respect of payments owing under the TRS. There would be no net deduction such that the only economic benefit to the financial institution is the fee it receives under the TRS

- The rule does not have an effect on any obligation that the financial institution or the payor of the dividend would have to withhold in respect of the payments made

- The rule would not apply to the fact situation in the Swiss case in which the financial institution that receives the dividend and enters into the TRS is a non-resident of Canada

- It is interesting that while the new rule is directed at total return swaps, the rule addresses the tax consequences of the arrangement to the financial intermediary rather than the tax consequences to the non-resident investor that gains exposure to Canadian equities in a manner that potentially avoids Canadian withholding tax

Substance of Companies

Renewed regulations on Dutch minimum substance requirements

- Decree on Dutch minimum substance requirements for DVL (*dienstverleningslichaam*) and information provision - adopted on 18 December 2013 and effective as per 1 January 2014
  - Codification of existing minimum substance requirements for stronger enforcement and for exchange of information with foreign tax authorities
- Updated regulations on APA's, ATR's and relating substance requirements – published on 12 June 2014
- Exchange of information
  - DVLs that do not meet substance requirements but apply tax treaties and/or EU I&R Directive
  - APAs for stand alone structures
- Extension substance rules to holdings - if ATR desired
- Extension substance rules to other categories (e.g. non-resident tax)

Definition DVL's under Decree and regulations

- Dutch taxpayer
- Whose activities in a year predominantly (70% or more) consist of: receiving and paying interest, royalties, rent or lease payments
- from respectively to non-Dutch tax residents
- forming part of a group of the taxpayer (article 10a and 8c sub 4 CITA)
- Holding activities to be disregarded for activities test
- Fiscal unity: measure by each separate entity (since the entity claims treaty protection)
  - Activities test and adequate equity test determined at fiscal unity level
- Definition to be interpreted the same as under ruling policy
- Relevant whether treaty or EU I&R Directive protection has or may be claimed for interest, royalties, rent or lease payments

Dutch minimum substance requirements for DVL's, APA's and ATR's

a) At least 50% Dutch resident board members (individuals or companies)
b) Board members should be sufficiently skilled to perform relevant tasks
c) Avail of qualified employees for proper implementation of transactions
d) Board decisions must be taken in the Netherlands
e) Main bank accounts must be maintained in the Netherlands
f) Bookkeeping must take place in the Netherlands
g) The registered address must be in the Netherlands.
h) To its knowledge, not considered tax resident elsewhere
i) Real risk as meant in article 8c sub 2 CITA
j) Equity must be adequate in relation to the functions performed (taking into account the assets used and the risks assumed)

Reporting obligations

- Declaration in tax return that ALL substance requirements are met
- Determined as per 1 January 2014
- If one or more requirements are not met:
  - Report which requirement(s) is (are) not met
  - Information on all other substance requirements
  - Overview of all interest, royalty, rent and leasing income for which treaty or EU directive protection has or may be claimed
  - Name and address of entities from which such income is received
- Subject to further guidelines

Sanctions non-compliance regulations

- Non-, inadequate or late provision of information: max. EUR 20,250 fine (2014)
- Spontaneous exchange of information to source country in respect of interest, royalty, rent or lease amounts for which treaty or EU I&R directive protection has or may be claimed
- Applies per 1 January 2014, so substance (incl. equity) had to be in place before 31 December 2013!
- Exchange of information APA's:
  - only for stand alone structures
  - status 'stand alone' to be determined in each APA procedure
  - for new APA's only
  - EU transparency package / MoU with Germany

Where do we expect issues?

- Holdings/joint-ventures with non-resident directors and financing/licensing in same entity
- Board meetings physically held in the Netherlands
- Shared service centers
  - Bring bookkeeping for DVL to the Netherlands, unless also active business in the Netherlands
  - Data collection
- Adequate equity test
  - Continuous test (must to meet article 8c CITA requirements and ruling policy)

German Approach on Substance

Sources for substance requirements

- General GAAR = pure letterbox companies are disregarded
- Inbound = anti-treaty-shopping rule
- Outbound = CFC rules (activity test and Cadbury Schweppes motive test)

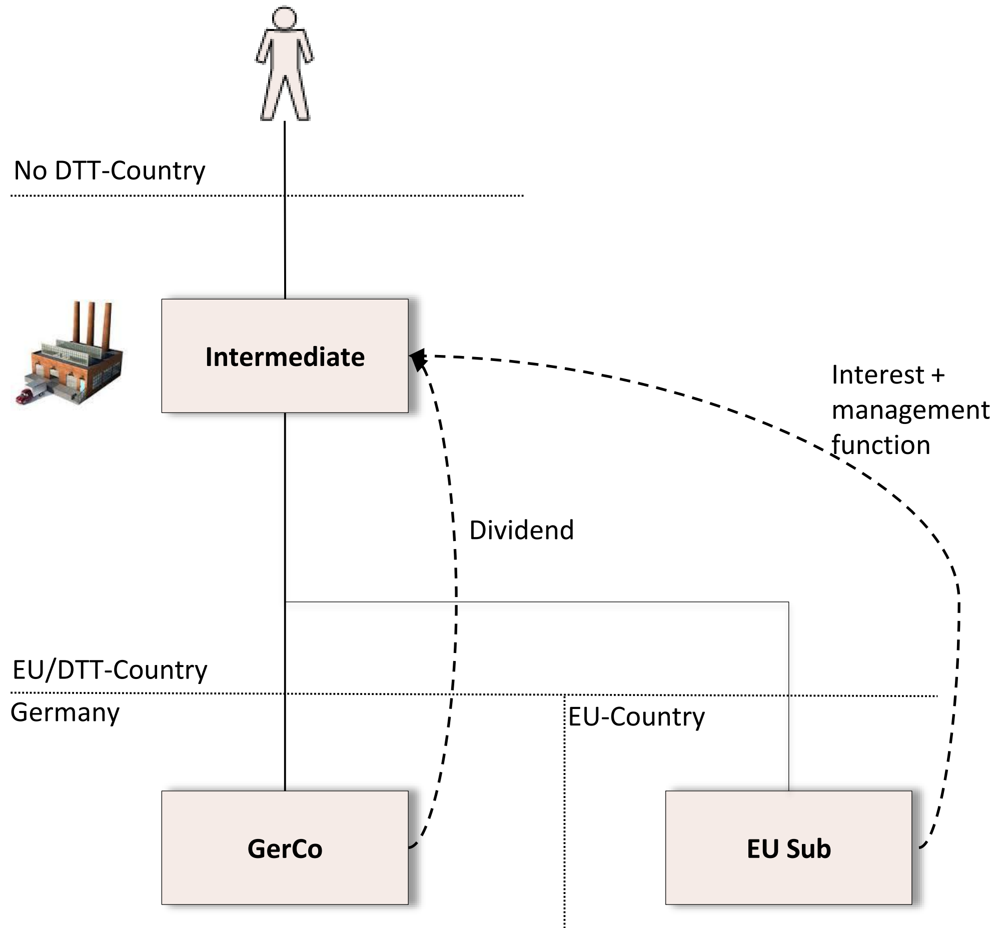
German Approach on Substance

P&L 2015

Dividend income	50	= passive
Manufacturing	50	= active
Interest income	50	= active
Profit	150	

Abuse of DTT = 33%

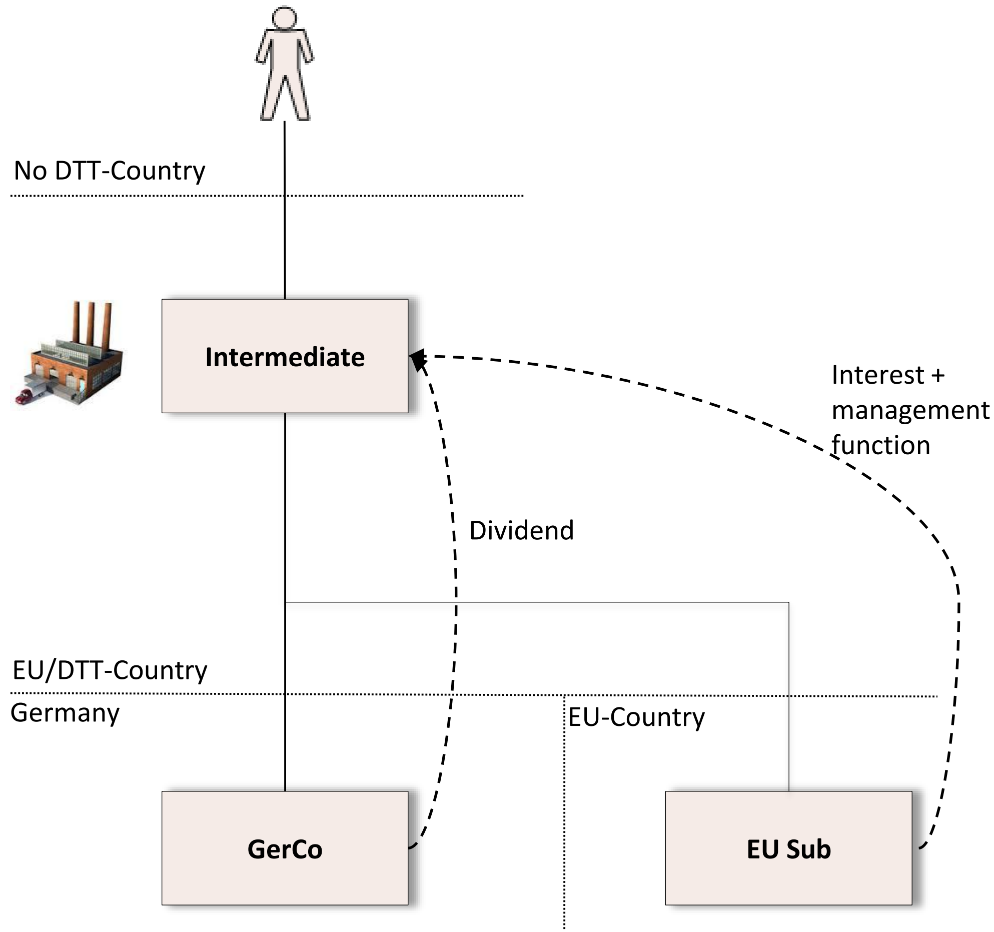
WTH to be levied = 25% x 33% = 8,33%



German Approach on Substance

Active portfolio management

- Influence on management decisions
- No mere shareholding function
- Decisions on substantial matters with long-term impact
- More than two subsidiaries



Proposed Changes to the U.S. Model Income Tax Treaty

May 20, 2015 Proposed Changes to the U.S. Model Income Tax Treaty

Five sets of changes altogether.

Three sets relate to Source State income subject to low taxation by the Residence State:

(1) Income attributable to a permanent establishment (PE) outside Residence State: No treaty benefits given by Source State in certain situations.

(2) Interest, royalties, or Art. 21 Other Income realized from a related payor and subject to a Special Tax Regime in Residence State: Source State treaty benefits *may* be denied.

(3) A Contracting State (CS) enacts a certain type of change to its tax law: Source State benefits *may* be denied (by both CSs) for dividends, interest, royalties, and Art. 21 Other Income realized by companies or individuals (depending on type of tax law change).

These three sets of changes flow from the OECD's mantra about the purpose of an income tax treaty.

The OECD’s Mantra Is False and Misleading

-- The OECD’s mantra is that the purpose of an income tax treaty is to “eliminate double taxation”.

-- The OECD’s mantra is false because an income tax treaty clearly permits double taxation, e.g.:

Art. 7 (Business Profits) – Both CSs may tax profits attributable to a PE;

Art. 10 (Dividends) – Both CSs may tax dividends paid by a resident of a CS to a resident of the other CS.

-- The OECD’s mantra is misleading because it implies that a Source State should only eliminate its tax if the income in question would otherwise be subject to double taxation or, from the U.S. Treasury’s perspective, *substantial* double taxation.

-- However, the purpose of an income tax treaty is to “coordinate taxation”, not “eliminate double taxation”.

-- As part of that coordination, State X may agree not to tax income realized by residents of State Y in exchange for State Y’s agreeing not to tax income realized by residents of State X. Under this reciprocal obligation, X should not care how Y taxes *its own residents*. The key is that Y agrees to give an exemption to residents of X.

-- Once a CS starts worrying about how the other CS taxes its own residents, a treaty becomes extremely complicated and for no valid policy reason.

The Limitation on Benefits (LOB) Article

(4) A fourth set of changes to the U.S. Model, proposed on May 20, 2015, relates to Article 22 (Limitation on Benefits). This set involves the following main changes:

(a) With respect to the exception for subsidiaries of publicly traded companies, addition of a base erosion test (for benefits other than benefits for dividends);

(b) Modification of the base erosion test to require application on a tested group basis and to treat persons subject to a Special Tax Regime as ineligible payees;

(c) Modification of the active trade or business exception to permit attribution to a resident of trade or business activities conducted by a connected person *only if* the resident and the connected person are engaged in the same or complementary lines of business;

(d) Addition of a derivative benefits exception (for companies), consisting of ownership and base erosion components; the ownership component is met if at least 95% of the company‘s stock is owned, directly or indirectly, by seven or fewer equivalent beneficiaries (and each intermediate owner is a qualifying intermediate owner); and

(e) Clarification that, in the case of a request for Competent Authority relief, the burden is on the resident to establish entitlement to relief, including that the resident has a substantial nontax nexus to the Residence State.

Expatriated Entities

(5) The fifth and final set of changes to the U.S. Model, proposed on May 20, 2015, relates to so-called expatriated entities.

In simplified terms, an expatriated entity is a U.S. corporation that had been the parent of a multinational group but, as a result of a corporate inversion, the group now has a foreign parent and the U.S. corporation is a subsidiary of the foreign parent.

Under this fifth set of changes, the United States will provide no treaty benefits during the period of ten years after the corporate inversion for U.S.-source dividends, interest, royalties, and Art. 21 Other Income realized in a transaction with the expatriated entity.

Thank you for your attention!