Deloitte.

Public Consultation

Double Tax Treaty with the United States of America

14 October 2016

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Consultation on Double Tax Treaty with the United States of America
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Dear Sir/Madam,

We are pleased to submit comments on behalf of Deloitte in response to your call for input on the Double Tax Treaty with the Unites States of America. We appreciate this opportunity to share our views and trust that you will find our comments valuable to the discussion.

We look forward to continued collaboration with the Department of Finance on this and other tax initiatives and are available to discuss anything in this document, as needed.

Yours faithfully,

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Table of Contents

Introduction

In February 2016, the United States Treasury published an update of the US Model Tax Treaty ("2016 Model"). This publication succeeded a draft update of the US Model Tax Treaty which was published in May 2015 and on which comments were received and considered by the Treasury Department in advance of the revised publication in 2016.

The existing Double Tax Treaty between Ireland and the United States was signed in 1997 and a Protocol to the Treaty was signed in 1999. The 1997 treaty and subsequent protocols are referred to as the "current treaty" throughout. This document includes our views on how the updating of the current treaty in line with the 2016 Model will impact on benefits being sought under the Ireland / USA Double Tax Treaty. The body of this submission contains a comparison of the articles in the current treaty with those in the 2016 Model and the perceived impact of same.

It should be noted that a Technical Explanation (TE) of the 2016 Model treaty was not available at the time of writing. To the extent that terms within the 2016 Model are similar to those in the current treaty then it has been assumed that the explanation contained in the TE of the current treaty will continue to be applied in interpreting the renegotiated treaty. If that is not the case then consideration would also have to be given to any revised Technical Explanation. A draft of some of the newly introduced provisions was published in May 2015 ("draft provisions") in the US and comments on same were considered in the publication of the 2016 Model. It is to be noted that a TE was issued as part of the draft provisions and consideration has been given to same where relevant throughout this document.

Further, it should be noted that reference is made in the 2016 Model to other countries' treaties with the US where it is necessary that such treaties contain similar provisions to those contained in the Model 2016 treaty before the benefits of that Model can be taken. This would mean that it may take some time before benefits under a renegotiated treaty would be available given that existing US treaties with third states may not have similar restrictions in their treaties such that appropriate comparability may not be possible. In addition, one must be mindful of negotiating a treaty that is acceptable to both the US and the EU e.g. the Netherlands has already been before the CJEU in respect of its treaty with Japan.

Executive Summary

The Preamble to the 2016 Model reiterates the policy of the US that tax treaties should eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance. This is similar to the approach of the OECD in its work as part of the Action 6 BEPS Report regarding the prevention of granting treaty benefits in inappropriate circumstances. The changes suggested in the 2016 Model reflect this policy by introducing several new provisions as well as tightening many of the pre-existing rules in an effort to prevent treaty abuse but go beyond the aforementioned BEPS standard in a number of matters. The provisions containing the most significant changes in the 2016 Model are discussed in detail in the next section of this document and some of the main effects are summarised below:

- The 2016 Model introduces a "special tax regime" (STR) concept to deny treaty benefits to certain items of income which benefit from such a regime whether or not a tax avoidance motive was present. This may impinge on bona fide transactions involving certain securitisations and collective investment undertakings which should not be the intent of a double tax treaty. At a minimum such regimes should be carved out from the STR provision
- The UK's tax treaty with the US allows a zero withholding tax rate on dividends in certain instances and therefore consideration should be given to applying a similar withholding rate in the renegotiated treaty for dividends to ensure that the treaty remains competitive.
- The 2016 Model places significant additional restrictions on the tests that are currently contained in the Limitations on Benefit (LOB) article of Ireland-US Treaty. It is likely that the 2016 Model will make it difficult for many companies and funds to qualify for treaty benefits and, at a minimum, will add additional complexity and uncertainty to nearly all companies' determinations of whether they qualify for treaty benefits.
- The LOB article in Model 2016 goes far beyond that recommended by the BEPS Report on same and indeed would deny treaty benefits to many Irish listed companies and funds, such as Exchange Traded Funds, which have their primary listing in, inter alia, the UK. It would be preferable to maintain the wording adopted in the Current Treaty.
- Indeed the LOB Article in Model 2016 adds a base erosion prong to the "subsidiary of a publicly traded company", "ownership", "derivative benefits" and "headquarters company" tests. The latter would allow treaty benefits for certain interest and dividends paid by members of a multinational corporation but the conditions there are quite onerous and in practice may benefit few companies as a result. Further, there is now the requirement in the LOB article for each qualifying intermediary within a corporate chain to be a Qualifying Intermediate Owner in the case of indirect ownership. These onerous provisions should be revisited with an emphasis on removing same.
- The 2016 Model brings about significant change for the financial services sector in addition to the STR point above. Collective Investment Undertakings would no longer be regarded as a resident for the purposes of the tax treaty thereby creating difficulties for access to the benefits in that treaty which could be damaging to the funds sector. Group treasury companies would no longer be regarded as carrying on an active trade or business for the purposes of meeting the LOB article. Given Ireland's status as a global financial services hub such proposals should not be included in a renegotiated treaty.
- The 2016 Model brings about additional complexity and administrative burdens in situations where Competent Authority relief will be sought e.g. under the new triangular branch rules, or with regard to the granting of benefits under the discretionary provisions in the LOB article.
- Indeed, there is no longer a tie breaker test where a company is treated as resident in both the US and the other Contracting State in Model 2016 as there is in the Current treaty. One can see the point if this was done with a tax avoidance motive but not if the company concerned is dual resident due to a mechanical mismatch of the laws of both jurisdictions.
- The renegotiation of certain of the terms in this treaty must be questioned given the upcoming Multilateral agreement with the OECD due to be published in November with effect from next year. Indeed, the 2016 Model goes far beyond the recommendations made in the Action 6 BEPS Report which looks to preventing the granting of treaty benefits in appropriate circumstances. Given that this report has been agreed by the OECD members it must be questioned as to why such additional, and indeed in most instances, more onerous provisions

are to be included as part of the 2016 Model. In the interest of certainty of application it would be preferable if any changes adopted were to be along the lines of those agreed and accepted by the OECD.

It can be seen from the above that additional complexity and uncertainty may be brought about if Model 2016 were to form the basis of a renegotiated treaty with the US. In addition, the Model treaty does not necessarily take into account the differences between a small open economy like Ireland and therefore significant information on the specifics of the Irish economy, nature of the business models and commercial operations here should form part of the negotiations. Overall the complexity of the treaty needs to be reduced and we make recommendations, in addition to those outlined above, as part of this document.

Comparison of the Current Treaty and the 2016 Model

This section focusses on the proposals outlined in the text of the 2016 Model treaty and the perceived impact of same as compared to, inter alia, the current treaty. Recommendations for negotiation purposes are highlighted throughout this discussion document.

Article 1 – General Scope

Para 4 allows the US to preserve its right to tax its residents and citizens in accordance with its domestic laws notwithstanding the application of the treaty. The current treaty includes a former citizen whose loss of citizenship had tax avoidance as one of its principal purposes and only for a period of 10 years following such loss. The 2016 Model does not have a tax avoidance purpose or indeed a time limit such that the treaty cannot affect US domestic laws in taxing former citizens. This could discourage a transfer of resources into Ireland and should be addressed as part of the negotiations.

Consideration should be given to restoring the tax avoidance motive and 10 year timeframe in determining whether US domestic law applies to a former citizen or long term resident.

Art 1(6) is a new introduction when compared to the current treaty. The 2016 Model modifies this provision which relates to fiscally transparent entities whereas the new provision applies to income "*derived by or through an entity that is treated as wholly or partially fiscally transparent*." Additionally, Art 22(7)(e)(i)(C) now provides that differences in the treatment of an entity as fiscally transparent is taken into account in determining whether a resident is an "equivalent beneficiary," for purposes of the LOB provisions and is discussed as part of those provisions. The extension of "looking through" the vehicle to include partially transparent vehicles to establish the application of the treaty is to be welcomed. However, the wording in the final sentence of art1(6) is curious in that where there are transparent structures in Ireland such as Common Contractual Funds (CCF) and Investment Limited Partnerships (ILPs) it is important that the US recognise such structures as tax transparent for their purposes.

Art 1(7) and 1(8) are both new introductions when compared with the current treaty. Art1(7) is a new provision that would limit the applicability of the treaty with respect to residents of a treaty state that are taxed on a remittance basis in their country of residence. In that case, treaty benefits would apply only to so much of the amount of income that is actually taxed in the residence state. Art 1(8) contains provisions that denies treaty benefits when certain income is attributable to a permanent establishment (PE) outside the beneficial owner's country of residence, the oft-called "triangular branch rules". This is a significant extension of those rules which are included in art23(7) of the current treaty.

Under the new rule in the 2016 Model, if an enterprise of Ireland derives income from the US that normally would qualify for treaty benefits, the benefits will be denied if Ireland treats that income as attributable to a PE situated outside Ireland (i.e., in the US or in a third country) and if those profits are subject to a combined aggregate effective tax rate in Ireland and the State in which the PE is located that is less than the lesser of (i) 15% or (ii) 60% of the general statutory rate of company tax in the residence State. Under the current art23(7) the test has one limb which is *"50 per cent of the generally applicable tax that would be imposed in Ireland on an enterprise deriving such item directly from the…"* However the entry point into this test in the current treaty requires, inter alia, that an enterprise of Ireland derive income from the US which is attributable to a third state and where "the enterprise is exempt from tax in Ireland on the profits attributable" to the

PE. This "exemption limb" is not within the 2016 Model such that its application has widened significantly.

Application of triangular branch rules no longer requires that income attributable to PE is exempt in Ireland such that its application has widened significantly. This application should be limited to that applying in the current treaty.

Even if this combined effective tax rate exceeds 15% or 60% of the general statutory rate of company tax in the residence State, treaty benefits will be denied if the PE is located in a third country that does not have a "comprehensive" treaty with the US, unless Ireland includes the income treated as attributable to the PE in its tax base which it should do in the first instance. Therefore, regard will be had to the first "15%/60%" test above. But for completeness, the reference to "comprehensive" treaty is curious in that it is not clear whether this would mean a treaty which is similar to that treaty under review i.e. the 2016 Model; if that is the case then it may be some time before such treaties exist given that the Irish treaty is, we understand, among the first to be renegotiated along the lines of the 2016 Model.

An important detail of the new PE rule is that the tax rates to be compared to determine if the reduction in tax is substantial are the effective rate of tax on the income and the general rate of corporate tax in the residence country. The rate comparison does not allow any adjustment for the fact that the effective tax rate typically will be significantly less than the general corporate rate due to deductions that may be properly allocable to the income or situations in which the company has losses. However, losses are given as an example as part of the latter limb of para 8 as one reason that the tax rate test is not met, and in such an instance the competent authorities of the US can still determine that the benefits will actually apply.

As noted above the competent authority of the US nevertheless may grant the benefits of the treaty with respect to a specific item of income if it determines that such grant of benefits is justified in light of the reasons the requirements were not satisfied. The inclusion of this specific provision suggests that the US Treasury recognizes that the rule may be too broad; unfortunately, the process of obtaining Competent Authority relief can be a lengthy and unpredictable process. Indeed, the current treaty includes the following "active trade or business test" as part of art 23(7) which is not part of the 2016 Model and it is submitted this should be reinstated as part of the proposed treaty with the US i.e.

"The provisions of this paragraph shall not apply if the income derived from the other Contracting State is connected with or incidental to the active conduct of a trade or business carried on by the permanent establishment in the third state (other than the business of making or managing investments, unless these activities are banking or insurance activities carried on by a bank or insurance company)".

It would be preferable if, in examining the effective rate of tax that consideration could be given to losses which are legitimately deducted in arriving at the taxable income and indeed the above active trading test. This would remove the need to approach the competent authorities for discretionary approval which would likely be a timely and complex process.

Consideration should be given to reinstating the active conduct of trade or business test which exists in the Current Treaty as part of the triangular branch provision.

The TE issued with the 2015 draft provisions in respect of the revised PE rules provide the following example as a source of motivation behind the change: *A resident of the other Contracting State sets up a permanent establishment in a third state that imposes a low or zero rate of tax on the income of the permanent establishment. The income attributable to the permanent establishment is exempt from tax by the other Contracting State, either pursuant to an income tax treaty in force between the other Contracting State and the third state where the*

permanent establishment is located or pursuant to the other Contracting State's domestic law. The resident of the other Contracting State lends funds into the United States through the permanent establishment. The permanent establishment, despite being situated in a third state, is an integral part of the resident of the other Contracting State. Therefore, interest received by the resident with respect to loans issued by the permanent established, absent the provisions of paragraph 7, would be entitled to exemption from U.S. withholding tax under the Convention (assuming all other requirements in Article 11 (Interest) have been satisfied). Thus, the interest income, absent paragraph 7, would be exempt from U.S. tax, subject to little or no tax in the third state of the permanent establishment, and exempt from tax in the other Contracting State. It is also noted in the TE that Paragraph 7 applies reciprocally. The United States, however, does not exempt the profits of a third-jurisdiction permanent establishment of a U.S. resident from U.S. tax, either by statute or by treaty. Ireland does not exempt such profits either so it would be preferable if the current treaty approach could be applied.

Ireland does not exempt branch profits so it would be preferable, as noted earlier, if the current treaty approach could regarding the triangular branch rule could be applied.

Article 2 – Taxes Covered

The extension of the US taxes covered by the treaty to include Federal taxes imposed on the investment income of foreign private foundations is welcome. That said, the treaty no longer covers "*… the Federal excise taxes imposed on insurance premiums paid to foreign insurers and with respect to private foundations (hereinafter referred to as " United States tax"). The Convention shall, however, apply to the Federal excise taxes imposed on insurance premiums paid to foreign insurers only to the extent that the risks covered by such premiums are not reinsured with a person not entitled to the benefits of this or any other convention which provides exemption from these taxes"* and this should be amended accordingly.

Consideration should be given to including the taxes covered by the Current treaty as part of the renegotiated treaty.

Article 3 – General Definitions

The definition of "***enterprise of a contracting state***" under Art3(1)(c) and related definitions under Art3(1)(d) and (e) are not contained in the Current Treaty. Under Art3(1)(c) of the 2016 Model, the term "*enterprise of a contracting state*" is now also taken to include an enterprise carried on by a resident of a Contracting State through an entity that is treated as fiscally transparent in that Contracting State. The TE to the 2006 Model notes that the inclusion of an enterprise carried on through a fiscally transparent entity (such as a partnership) in the definition is to ensure that the purpose of the Convention is not thwarted by an overly technical application of the term "enterprise of a Contracting State" to activities carried on through partnerships and similar entities. Therefore, it would appear unlikely that the US would move away from such a definition.

Art3(k) is new with regard to the Current Treaty. It defines the term **"pension fund"** as being "any person established in a Contracting State that is:

i) generally exempt from income taxation in that Contracting State; and
ii) operated exclusively or almost exclusively:
A) to administer or provide pension or retirement benefits; or
B) to earn income for the benefit of one or more persons established in the same Contracting State that are generally exempt from income taxation in that Contracting State and that are operated exclusively or almost exclusively to administer or provide pension or retirement benefits;"

The term "**pension fund**" is used throughout Art 17 and 18 of the 2016 Model. It is to be noted that this new definition is also referred to in Art 4 relating to the explanation of a resident of a Contracting State and has effectively replaced a reference therein to "*Collective Investment Undertakings and similar investment entities….*[hereinafter CIUs]" This is a significant development and is discussed further in Art 4. It is submitted that such definition be removed and reliance had on the reference to the CIU contained in the current treaty. Further, a competent authority clarification was given in 2006 in connection with Common Contractual Funds (CCF) and this should be addressed as part of a renegotiated treaty. This is discussed in more detail in Art4 below.

The proposed replacement of "Collective Investment Undertakings" with "pension funds" should be revisited and not included as part of a renegotiated treaty given the uncertainty that this would bring to financial services. The previous competent authority clarification given for CCFs should also be addressed as part of the renegotiated treaty.

Art 3(1)(l), is a new introduction in comparison to the Current Treaty. It contains the provisions for the introduction of a "**special tax regime**" (STR) which is not contained in the LOB suggested by the Action 6 BEPS report. Related amendments are also made to Art11 (Interest), Art 12 (Royalties), and Art 21 (Other Income) which impact a person's ability to claim treaty benefits for payments from related parties for interest, royalties, and certain guarantee fees if the beneficial owner of the respective payment benefits from a STR. According to the Preamble to the 2016 Model, the STR provisions are intended to prevent the use of tax treaties to facilitate incidences of double non-taxation, in particular where countries implement preferential regimes to attract highly mobile income. An STR is defined as follows:

"The term "special tax regime" means any statute, regulation or administrative practice in a Contracting State with respect to a tax described in Article 2 (Taxes Covered) that meets all of the following conditions:

i) results in one or more of the following:
- *A) a preferential rate of taxation for interest, royalties, guarantee fees or any combination thereof, as compared to income from sales of goods or services;*
- *B) a permanent reduction in the tax base with respect to interest, royalties, guarantee fees or any combination thereof, without a comparable reduction for income from sales of goods or services, by allowing:*
  - *1) an exclusion from gross receipts;*
  - *2) a deduction without regard to any corresponding payment or obligation to make a payment;*
  - *3) a deduction for dividends paid or accrued; or*
  - *4) taxation that is inconsistent with the principles of Article 7 (Business Profits) or Article 9 (Associated Enterprises); or*
- *C) a preferential rate of taxation or a permanent reduction in the tax base of the type described in part (1), (2), (3) or (4) of subclause (B) of this clause with respect to substantially all of a company's income or substantially all of a company's foreign source income, for companies that do not engage in the active conduct of a trade or business in that Contracting State;*

ii) in the case of any preferential rate of taxation or permanent reduction in the tax base for royalties, does not condition such benefits on the extent of research and development activities that take place in the Contracting State;

iii) is generally expected to result in a rate of taxation that is less than the lesser of either:
- *A) 15 percent; or*
- *B) 60 percent of the general statutory rate of company tax applicable in the other Contracting State;*

iv) does not apply principally to:
- *A) pension funds;*
- *B) organizations that are established and maintained exclusively for religious, charitable, scientific, artistic, cultural or educational purposes;*

C) persons the taxation of which achieves a single level of taxation either in the hands of the person or the person's shareholders (with at most one year of deferral), that hold a diversified portfolio of securities, that are subject to investor-protection regulation in the Contracting State and the interests in which are marketed primarily to retail investors; or
D) persons the taxation of which achieves a single level of taxation either in the hands of the person or the person's shareholders (with at most one year of deferral) and that hold predominantly real estate assets; and

v) after consultation with the first-mentioned Contracting State, has been identified by the other Contracting State through diplomatic channels to the first-mentioned Contracting State as satisfying clauses (i) through (iv) of this subparagraph".

Importantly, no statute, regulation or administrative practice in a State shall be treated as a STR until the other State has consulted with the first-mentioned State and then 30 days have passed after the other State issues a written public notification identifying the regime as such.

For example, art11(2)(c) notes as follows *"Notwithstanding the provisions of paragraph 1 of this Article:…c) interest arising in a Contracting State and beneficially owned by a resident of the other Contracting State that is a connected person with respect to the payor of the interest may be taxed in the first-mentioned Contracting State in accordance with domestic law if such resident benefits from a special tax regime with respect to such interest in its Contracting State of residence;…"* The similarities with the provisions in the royalties article can be seen.

Where an Irish resident company receives interest from a connected party in the US then it is likely that that interest will be taxable under Case III rules with no deduction applying. That treatment will be disapplied where the Irish company received it as part of its trading income or indeed by a securitisation vehicle or fund. A trading company will calculate its profits for Irish tax purposes in a manner similar to that *"as compared to income from sales of goods or services"* but that will not be the case for securitisation vehicles or funds.

Taking securitisation vehicles firstly. Securitisations and securitisation companies are essential to and an integral part of the financial services sector. They facilitate the proper functioning of the financial services sector and the economy and aid in a country's economic growth. They provide many benefits, for example, they provide financial institutions such as banks with liquidity allowing them to refinance financial assets such as loans. Therefore securitisations can allow a financial institution to transform certain financial assets into liquid assets which might otherwise sit indefinitely on a company's balance sheet. Securitisations free up a company's balance sheet and capital requirements allowing the company to increase its trading activity for example by allowing a bank to provide new loans to businesses which can facilitate a country's overall economic growth.

Broadly, securitisation companies' main purpose is to transfer risks and return from financial assets from one entity (generally referred to as 'the originator') to new investors. In the context of the Irish securitisation regime, the securitisation company acquires financial assets and the purpose of the profit participating note is to properly facilitate the transfer of risk and return to new investors. Its function is not tax avoidance. As part of a properly functioning securitisation regime the securitisation company should be tax neutral, thereby allowing the transfer of this risk and reward in an efficient and cost effective manner.

In that instance, such vehicles pay tax at 25% on their profits but they can deduct an amount for "profit participating interest" on funding notes issued to investors such that the vehicle makes a low level of profits and pays the appropriate corporation tax on those profits in Ireland. Granted the nominal rate applying to such profits is higher than that of companies with income from sales of goods or services but the deduction for profit participating interest is something which only applies to securitisation vehicles such that the effective rate of taxation may be substantially less than the nominal rate. So applying the tests above to the deduction allowable for profit participating interest in a securitisation vehicle:-

(i) the deduction may give rise to a permanent reduction in the tax base with respect to interest as it would appear likely that such deduction may be inconsistent with OECD arm's length principles;
(ii) not applicable,

(iii) it would be expected that the effective tax rate of the vehicle would be lower than the rates mentioned and

(iv) it does not apply principally to A) pension funds; B) organisations that are established and maintained exclusively for religious, charitable, scientific, artistic, cultural or educational purposes; C) persons the taxation of which achieves a single level of taxation either in the hands of the person or the person's shareholders (with at most one year of deferral), that hold a diversified portfolio of securities, that are subject to investor-protection regulation in the Contracting State and the interests in which are marketed primarily to retail investors; or D) persons the taxation of which achieves a single level of taxation either in the hands of the person or the person's shareholders (with at most one year of deferral) and that hold predominantly real estate assets; …"

This may give additional concerns for securitisations generally given the commercial and tax legislative intent that they be regarded as neutral for tax purposes.

Looking now to funds and REITs and the same analysis could apply in that the vehicles concerned may fail test (iv)(C) and (D) in that such regimes apply to *"C) persons the taxation of which achieves a single level of taxation either in the hands of the person or the person's shareholders (with at most one year of deferral), that hold a diversified portfolio of securities, that are subject to investor-protection regulation in the Contracting State and the interests in which are marketed primarily to retail investors; or D) persons the taxation of which achieves a single level of taxation either in the hands of the person or the person's shareholders (with at most one year of deferral) and that hold predominantly real estate assets;…"* Nonetheless this demonstrates the level of analysis required. The reference to "one year of deferral" above is curious and if this means that taxation of shareholders has to be subject to tax within one year of profits arising within the fund then this will give rise to difficult issues for the funds industry. This issue has to be linked with the more fundamental omission of "*Collective Investment Undertakings*" from the "resident in a Contracting State" definition in art4 which is discussed later in this document.

As part of his speech to the City of London Corporation on September 22 Minister Noonan noted a "whole of government" approach to driving the growth and development of the international financial services sector in Ireland and to drive forward the IFS 2020. The Strategy sets an ambitious target of growing the international financial services sector in Ireland by 30% over the five year period to 2020. He noted that the in *"…terms of vision for the Strategy, we want Ireland to be recognised as the global location of choice for specialised international financial services. We want to build on our strengths in talent, technology, innovation and excellent client service. We will focus on capturing new opportunities in a changing market and embracing the highest forms of governance…Ireland's strategic objective is to place ourselves firmly at the cutting edge of financial services innovation. This focus on innovation and specialisation aligns with the strategic agenda that IFS companies themselves are already heavily invested in".* Therefore, the proposed treaty amendments in the 2016 Model should not hamper such strategy.

It is likely that the Irish funds regime would constitute a STR under Model 2016 given that it is possible to defer "shareholder" taxation beyond 1 year and indeed there is a deemed exit charge in Irish law after 8 years to the extent that distributions have not occurred in that period. However as Minister Noonan noted recently: "*The broad rationale for exempting such funds from direct taxation is to facilitate individuals to invest collectively, without suffering double taxation, that is, taxation both within the fund and in the hands of the investor on distribution. Most OECD countries now have a tax system that provides for neutrality between direct investments and investments through a collective investment vehicle or fund."* Therefore such regimes are not unusual and taking the example of the interest article discussed above could mean a denial of treaty benefits where such funds receive interest from a connected person which could occur regarding payments from certain sub-funds etc. Collective Investment Undertakings are discussed in further detail as part of the discussion on Art4 given the substantial amendments to that article proposed by model 2016.

The inclusion of a STR provision brings additional complexity to the application of the treaty given it affects so many articles of the treaty including LOB. It is suggested that this be excluded particularly given that the OECD BEPS Action 6 report does not include a reference to same therein or as part of its suggested LOB provision. Amendment of the STR definition in the proposed treaty should be made to ensure that, inter alia, securitisations and Collective Investment Undertakings are not affected as part of a renegotiated treaty.

Art 3(1)(m) is also a newly introduced article which covers the definition of "**Connected Persons**" which is used throughout the 2016 Model, particularly in Art 22 (Limitation on Benefits) with regard to the types of impermissible payments for the Base Erosion tests under the subsidiary of a listed company, ownership, derivatives and Headquartered company tests (discussed in more detail under Art 22), and in the Dividend, Interest and Royalty Articles with respect to the new corporate inversion provisions (discussed under Art 10/11/12). Two persons are treated as "connected persons" if one owns, directly or indirectly, at least 50 percent of the beneficial interest in the other (or, in the case of a company, at least 50 percent of the aggregate vote and value of the company's shares) or another person owns, directly or indirectly, at least 50 percent of the beneficial interest (or, in the case of a company, at least 50 percent of the aggregate vote and value of the company's shares) in each person. In any case, a person shall be connected to another if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same person or persons.

The inclusion of connected persons definition allows certain treaty provisions not to apply e.g. art10(5) regarding expatriated entities etc. Consideration should be given to accompanying such provisions with a tax avoidance purpose such that bona fides transactions between connected persons without a tax avoidance purpose can still benefit from the treaty.

Article 4 – Resident

A number of proposed amendments to the Current treaty are contained within this article. The additional exclusion in para 1 of *"any person whose tax is determined in the Contracting State on a fixed fee, "forfait" or similar basis"* can bring some uncertainty to the application of the treaty. It is questionable whether a "fixed fee" could be wide enough to include certain branches remunerated on a cost plus basis where it is the "plus" which could be regarded as a fixed fee i.e. does the word "fee" comprise a monetary amount or an agreed proportion of remuneration? We presume that the latter should not be the case but clarification should be sought and included in any forthcoming TE.

In Art4(1) the inclusion of residence by "*citizenship*" seems to replace the following extract from the 1997 treaty in its definition of "resident" being *"A United States citizen or an alien lawfully admitted for permanent residence in the United States is a resident of the United States, but only if such person has a substantial presence, permanent home or habitual abode in the United States".* The latter limb has been therefore removed and should be included as part of the treaty renegotiation.

Consideration to be given to clarification of meaning of "fixed fee" and reinserting *"…alien lawfully admitted for permanent residence in the United States is a resident of the United States, but only if such person has a substantial presence, permanent home or habitual abode in the United States"* as part of the resident of a contracting state definition.

Art4(2) of the treaty, while including a pension fund established in a Contracting State and an organisation that is established and maintained in that Contracting State exclusively for religious, charitable, scientific, artistic, cultural, or educational purposes notwithstanding a full or partial exemption on its income or gains does not go as far as the current treaty. That treaty also included

"…a pension trust and any other organization established in that State and maintained exclusively to administer or provide retirement or employee benefits that is established or sponsored by a person that is otherwise a resident under Article 4 (Residence); and any charitable or other exempt organization, provided that the use of the organization's assets, both currently and upon the dissolution or liquidation of such organization, is limited to the accomplishment of the purposes that serve as the basis for such organization's exemption from income tax;

… in the case of the United States, a Regulated Investment Company and a Real Estate Investment Trust; in the case of Ireland, a Collective Investment Undertaking; and any similar investment entities agreed upon by the competent authorities of both Contracting States"

The specific reference to a "Collective Investment Undertaking" from an Irish perspective is an important omission from Model 2016 in that absent its inclusion then one would have to have regard to Art4(1) which has a "liable to tax" test. Granted the new definition includes a "pension fund" but that is limited in art3(1)(k) to any person established in established in a Contracting State *"that is:*

i) generally exempt from income taxation in that Contracting State; and ii) operated exclusively or almost exclusively:

A) to administer or provide pension or retirement benefits; or

B) to earn income for the benefit of one or more persons established in the same Contracting State that are generally exempt from income taxation in that Contracting State and that are operated exclusively or almost exclusively to administer or provide pension or retirement benefits;…"

It can be seen from the above that a Collective Investment Vehicle would be of wider significance than a pension fund and therefore its inclusion in any renegotiated treaty is of importance. Further, the following clarification was given by the Competent Authorities in relation to Common Contractual Funds (CCF) and should be addressed as part of a renegotiated treaty.

The Competent Authorities agree that in order to reach the result intended by the Contracting States, a CCF will not be treated as a resident of Ireland pursuant to paragraph 1(d) of Article 4. Accordingly, under the first sentence of Article 1 of the Protocol, a unit holder in a CCF will be entitled to benefits under the Treaty, provided the unit holder is a resident of Ireland that satisfies the requirements of Article 23 (Limitation on Benefits). In addition, a CCF will not be entitled to benefits in its own right because it will not be a resident of Ireland.

The funds industry in Ireland is one which employs c.15,000 people and is an essential part of Ireland's financial services offering and Appendix II outlines some statistics available from the Irishfunds.ie website regarding the level of activity in Ireland in connection with various fund structures. It is generally accepted that Irish exchange traded funds, which constitute the largest portion of European exchange traded funds, are generally entitled to claim US treaty benefits. Equally, Irish funds with more than 50% Irish and US investors are also generally entitled to claim US treaty benefits. These results benefit both Ireland, in maintaining and growing its reputation as the onshore domicile of choice for regulated investment funds, and the US, in facilitating the investment of substantial investment capital held by Irish regulated funds in the US. Irish domiciled regulated funds now hold over $2 trillion in investment capital and applies to assets and countries all over the globe. Commercially, a substantial proportion of this investment capital would be invested in the US given its position in worldwide financial markets. However, if taxation in the US were now to apply then many investment funds may decide to look for alternative jurisdictions outside the US which may lead to further capital exportation from the US. In addition, as Ireland is the no.1 location in the EU for exchange traded funds (ETFs) ensuring such ETFs can

continue to qualify for the US-Ireland tax treaty is vital as the art4 and art22 (listed companies' element) is key to their qualification.

Further, it is noteworthy that Finance Act 2015 specifically amended TCA97 s734(1) when legislating for the Irish Collective Asset-management Vehicles Act 2015 to ensure that an ICAV would come within the domestic tax definition of a collective investment undertaking thereby ensuring US treaty benefits would be available for same. Therefore, ensuring the treaty does not interfere with such industry is of significant importance.

The 2016 Model includes "*that Contracting State and any political subdivision or local authority thereof*" as part of the meaning of resident of a contracting state in article 4(1). The current treaty however includes "*…a qualified governmental entity of that State"* with this term meaning:

> *i. any person that constitutes the Government or a Department of Government of a Contracting State, or a political subdivision or local authority of a Contracting State;*
>
> *ii. a person that is wholly owned, or the beneficial interest of which is wholly owned, directly or indirectly, by a Contracting State or a political subdivision or local authority of a Contracting State, provided (A) it is organized under the laws of the Contracting State, (B) its earnings are credited to its own account and (C) its assets vest in the Contracting State, political subdivision or local authority upon its dissolution; and*
> *iii. a pension trust or fund of a person described in subparagraph (i) or (ii) that is constituted and operated exclusively to administer or provide pension benefits described in Article 19 (Government Service),*
>
> *iv. provided the income of the entity does not inure to the benefit of a private person and the entity does not carry on commercial activity.*

As such the term in the current treaty is broader than that in the 2016 Model and should be restored.

Reference to "collective Investment undertakings" and "*…a qualified governmental entity of that State"* should be restored as part of the definition of "resident of a Contracting State" for the purposes of a renegotiated treaty. This is supported by the OECD reports on CIVs and treaty access.

Where a company is regarded as being a resident of both countries then under the current treaty it was up to the Competent Authorities of US and Ireland to determine the jurisdiction of residence. The 2016 Model treaty simply denies treaty benefits to that company without any recourse. It would seem unduly harsh to exclude some element of tie breaker rule particularly when the OECD model and indeed the previous US treaty have same, albeit with differing solutions.

A tie-breaker rule should be inserted into the renegotiated treaty.

Article 5 – Permanent Establishment

The Current Treaty provides that a construction site lasting less than 12 months is not a PE. The 2016 Model provides an anti-abuse rule directed at this exception through contract splitting where multiple related entities are involved with the construction and the overall project lasts longer than 12 months, but each entity on a separate basis has less than 12 months of involvement. This provision is an incorporation of the measures recommended under BEPS Action 7. Appendix II to this document outlines a comparison of the holding requirements of such PE's in US treaties with EU partners for information.

The new provisions do not adopt the other BEPS recommendations regarding the permanent establishment threshold, notably the revised rules related to dependent and independent agents and the exemption for preparatory and auxiliary activities. This is noted in the Preamble to the 2016 Model which states that the Treasury Department is "*working with OECD and G20 member*

countries to create a common global understanding regarding profit attribution that will address the concerns raised by these BEPS permanent establishment recommendations. Furthermore, the Treasury Department is interested in developing ways to mitigate the compliance burdens on businesses and tax administrations that the new permanent establishment rules could create". In any event, this may form part of the Multilateral agreement in the first instance.

Article 6 – Income from real property (Immovable Property)

Under the 2016 Model, the definition of immovable property includes "*property accessory to real property (immovable property), livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of real property (immovable property) and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources. Ships and aircraft shall not be regarded as real property (immovable property)*."This content is not included in the Current Treaty.

The TE notes that this definition conforms to the OECD Model Treaty. Ireland does not appear to have raised any reservations on the article. In addition, the 2016 Model contains a provision that a resident of one Contracting State that derives real property income from the other may elect, for any taxable year, to be subject to tax in that other State on a net basis, as though the income were attributable to a permanent establishment in that other State. This provision is absent from the Current Treaty and would appear to extend the deductions that would be available to taxpayers as a result.

Article 7 – Business Profits

In determining the amount of profits to be allocated to a PE, there is additional wording included in Art 7(2) of the 2016 Model which is absent from the Current Treaty. It notes that the profits to be attributed… *"taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise".* Similar wording is contained in the 2006 model and the TE on same notes that this incorporates the arm's length standard for the purposes of determining the profits attributable to a PE and the US generally interprets the arm's length standard in a manner consistent with the OECD Transfer Pricing Guidelines. That said, the use of the expression "taking into account" would seem an inclusive rather than exhaustive requirement and it is difficult to see what else could be taken into account. Therefore, clarification that the measures to be taken into account are *only* functions performed, assets used and risks assumed and that this list is an exhaustive one should be sought as part of any renegotiated treaty.

Confirmation that *only*, profits, assets and risks are to be taken into account in determining the profits attributable to a permanent establishment as part of any renegotiated treaty.

The Current Treaty contains provisions for the allowance of deductions that are incurred for the purposes of the PE in determining the profits of the PE "*including a reasonable allocation of executive and general administrative expenses, research and development expenses, interest, and other expenses incurred for the purposes of the enterprise as a whole (or the part thereof which includes the permanent establishment), whether incurred in the State in which the permanent establishment is situated or elsewhere*." Such a provision is absent from the 2016 Model and the new introduction of the functions, assets and risks test dictates that any allocation would be in line with the OECD arm's length principle. However, such specific reference to these deductions was deemed necessary in the Current treaty, notwithstanding the separate entity approach adopted in the current treaty's art7(2) and it would be beneficial if such text were reinstated for additional certainty.

Consideration to be given to restoring a deduction for a reasonable allocation of executive and general administrative expenses, research and development expenses, interest, and other expenses incurred for the purposes of the enterprise as a whole as was the case in the previous treaty.

In addition, there is new wording introduced in Art 7(3) of the 2016 Model which provides that if one of the treaty partner countries makes a transfer pricing adjustment to profits attributable to an enterprise's PE in one of the States and accordingly taxes profits of the enterprise that have been taxed by the other State, then the other State must make an appropriate corresponding adjustment to the extent necessary to eliminate double taxation if it agrees with the adjustment made by the first State. If it does not agree, then the two States are required to consult to eliminate double taxation resulting from the transfer pricing adjustment by mutual agreement. This requirement to eliminate double taxation resulting from transfer pricing adjustments in one country without a corresponding adjustment by the other country is a welcome addition to the Model Treaty. It may raise complex procedural questions – for example, where two countries have different periods of limitation on tax assessments, whether this provision could override the statute of limitations under US federal income tax law in certain cases. It is necessary to note that art9 of the current treaty provided for a correlative adjustment in any event and that paragraph has been carried over into the model treaty.

Article 8 – Shipping and Transport

There are no changes impacting the Current Treaty under this Article. However, as discussed under Art22, the provisions contained in Art23(4) of the current treaty with regard to deriving income under Art8 has not been included in the 2016 Model and we suggest this be inserted as part of the renegotiations. This is discussed further as part of the LOB article in this document.

Article 9 – Associated Enterprises

There are no changes impacting the Current Treaty under this Article.

Article 10 – Dividends

Payments by "expatriated entities"

A new provision is inserted in Art 10(5) (Dividends), Art 11(2)(d) (Interest), Art 12(2)(b) (Royalties) and Art 21(2)(b) (Other Income) with regard to corporate inversions. The provision seeks to deny treaty benefits for US withholding taxes on certain US sourced dividends, interest, royalties and certain guarantee fees paid by US companies that are "expatriated entities", as follows:

For the US, dividends/interest/royalties/guarantee fee "…*paid by an expatriated entity and beneficially owned by a company resident in [Ireland] that is a connected person with respect to such expatriated entity may be taxed in accordance with the law of the United States for a period of ten years beginning on the date on which the acquisition of the domestic entity is completed. For purposes of applying this paragraph:*

i) no effect shall be given to any amendment to section 7874 of the Internal Revenue Code after the date of signature of this Convention; and

ii) ii) no entity shall be treated as an expatriated entity that:

A) is a connected person with respect to the domestic entity immediately after the date on which the acquisition of the domestic entity is completed; and

B) prior to that date, was never a connected person with respect to the domestic entity.

However, an entity described in the preceding sentence shall become an expatriated entity if, subsequent to the date on which the acquisition of the domestic entity is completed, the entity joins in filing a U.S. consolidated return with either the domestic entity or another entity that was a connected person with respect to the domestic entity immediately prior to the date on which the acquisition of the domestic entity was completed".

An "expatriated entity" is defined in the Internal Revenue Code in Section 7874(a)(2)(A) and in general means *"the domestic corporation or partnership…with respect to which a foreign corporation is a surrogate foreign corporation, and any United States person who is related… to a domestic corporation or partnership"*. Section 7874(a)(2)(B) of the Internal Revenue Code notes that a foreign corporation shall be treated as a surrogate foreign corporation if the entity completes the direct or indirect acquisition of substantially all of the properties held directly or indirectly by a domestic corporation or substantially all of the properties constituting a trade or business of a domestic partnership. After the acquisition at least 60 percent of the stock (by vote or value) of the entity must be held by former shareholders of the domestic corporation or by former partners of the domestic partnership and after the acquisition the expanded affiliated group which includes the entity does not have substantial business activities in the foreign country in which, or under the law of which, the entity is created or organized, when compared to the total business activities of such expanded affiliated group. In addition, section 7874(a)(3)(b) of the Internal Revenue Code notes that a foreign corporation shall be treated as a domestic corporation if such corporation would be a surrogate foreign corporation if the ownership requirement noted above was 80% as opposed to 60%.

According to the preamble to the 2016 Model, Treasury has sought to provide certainty about the scope of the Model's expatriated entities provision by fixing the definition of expatriated entity "to the meaning it has under Internal Revenue Code section 7874(a)(2)(A) as of the date the bilateral tax treaty is signed." While this approach would mean that future legislative provisions regarding Section 7874 made after a treaty is signed would not impact application of this provision to the treaty, it appears that any further regulatory action Treasury might take to expand the reach of Section 7874 would not enjoy similar protection. Moreover, if Congress decided to repeal Section 7874 or to scale it back, it would appear that Section 7874 as in effect before such change would continue to apply, so that an entity that would not be treated as expatriated under US law nevertheless could be treated as expatriated for purposes of a treaty.

It can be seen from the above that a 10 year prevention of treaty benefits could be disproportionate to the avoidance that may or may not have occurred. The point was made in connection with the definition of connected persons in art3 that that test be accompanied by a tax avoidance purpose such that bona fides transactions without a tax avoidance purpose can still benefit from the treaty. This would bring about additional subjectivity. Negotiations should seek to clarify scope and intent of the expatriated entity provisions in the 2016 Model, and whether the provisions should be linked with a specific tax avoidance motive. Indeed consideration should be given to reducing the 10 year period above. The points made here apply to Art 10(5) (Dividends), Art 11(2)(d) (Interest), Art 12(2)(b) (Royalties) and Art 21(2)(b) Other Income with regard to corporate inversions.

Remaining provisions in art10

Appendix I to this submission outlines the rates of withholding tax permitted by members of the European Union based on their US treaties. Like the 2006 model and in contrast to certain US treaties already in force the 2016 Model does not allow for an exemption from withholding tax on dividends received and beneficially owned by companies that hold certain 80% interests in the company paying the dividend. For example the UK-US treaty has the following clause and we would argue that this should form part of the treaty negotiations for inclusion in the revised treaty.

"*Notwithstanding the provisions of paragraph 2 of this Article* [which applies a 5% rate for 10% voting power or 15% otherwise], *dividends shall not be taxed in the Contracting State of which the company paying the dividends is a resident if the beneficial owner of the dividends is a resident of the other Contracting State and either:*

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

- *(i)* *owned shares representing, directly or indirectly, at least 80 per cent of the voting power of the company paying the dividends prior to October 1st, 1998; or*
- *(ii)* *is a qualified person by reason of sub-paragraph (c) of paragraph 2 of Article 23 (Limitation on benefits) of this Convention [*this is the listed company test and includes a subsidiary of a plc]*; or*
- *(iii)* *is entitled to benefits with respect to the dividends under paragraph 3 or paragraph 6 of that Article* [the derivatives test or the discretionary test] *; or*

(b) *a pension scheme, provided that such dividends are not derived from the carrying on of a business, directly or indirectly, by such pension scheme."*

The option under clause (a) of the above should therefore be considered for inclusion as part of the Irish renegotiations. In particular, as part of the negotiations for the introduction of the above provision into the US-UK treaty, a Report from the Committee on Foreign Relations to the Senate on March 13, 2003 noted that dividend withholding taxes are commonly viewed as barriers to cross-border investment and the principal argument in favour of eliminating withholding taxes on certain direct dividends in the US-UK treaty was that it would remove one such barrier. It noted

"Since the United Kingdom does not impose a withholding tax on these dividends under its internal law, the zero-rate provision would principally benefit direct investment in the United States by U.K. companies, as opposed to direct investment in the United Kingdom by U.S. companies. In other words, the potential benefits of the provision would accrue mainly in situations in which the United States is importing capital, as opposed to exporting it. Adopting a zero-rate provision in the U.S.-U.K. treaty would have uncertain revenue effects for the United States. The United States would forgo the 5-percent tax that it currently collects on qualifying dividends paid by U.S. subsidiaries to U.K. parent companies, but since the United Kingdom currently does not impose any tax on comparable dividends paid by U.K. subsidiaries to U.S. parent companies, there would be no offsetting revenue gain to the United States in the form of decreased foreign tax credit claims with respect to withholding taxes.

However, in order to account for the recent repeal of the U.K. advance corporation tax and related developments, the proposed treaty also eliminates a provision of the present treaty requiring the United States to provide a foreign tax credit with respect to certain dividends received from U.K. companies. On balance, these two effects are likely to increase revenues for the U.S. fisc. Over the longer term, if capital investment in the United States by U.K. persons is made more attractive, total investment in the United States may increase, ultimately creating a larger domestic tax base. However, if increased investment in the United States by U.K. persons displaced other foreign or U.S. investments in the United States, there would be no increase in the domestic tax base.…Revenue considerations aside, the removal of an impediment to the import of capital from the United Kingdom into the United States is a not-inconsiderable economic benefit. Further, it should be noted that, although U.K. internal law currently does not impose a withholding tax on dividends paid to foreign persons, there is no guarantee that this will always be the case. Thus, the inclusion of a zero-rate provision in the treaty would give U.S.-based enterprises somewhat greater certainty as to the applicability of a zero rate in the United Kingdom, which arguably would facilitate long-range business planning for U.S. companies in their capacities as capital exporters. Along the same lines, the provision would protect the U.S. fisc against increased foreign tax credit claims in the event that the U.K. were to change its internal law in this regard. …".

Ireland, like the UK, operates a domestic exemption from DWT for dividends paid to certain non-resident companies under TCA 1997 s172D. With respect to dividends paid by Irish subsidiaries to US parent companies, the effect of this provision would be to lock in the currently applicable zero rate of Irish withholding tax, regardless of how Irish domestic law might change in this regard. Therefore the arguments made above by the Senate Committee apply equally in this instance.

Consideration should be given to a tax exemption along the above lines for dividends to ensure the renegotiated treaty remains competitive with the UK and other US treaties.

That said, and for completeness purposes, what follows is a discussion of the requirements for a reduced rate of 5%. Under the 1997 treaty the 5% rate of tax applies to gross dividends *"…if the beneficial owner of the dividends is a resident of the other Contracting State, except as otherwise provided in this Article, the tax so charged shall not exceed… 5 percent of the gross amount of the dividends if the beneficial owner is a company that owns at least 10 percent of the voting stock of the company paying the dividends;".* This was a simple factual test which was not too dissimilar from the approach adopted by the OECD in its Convention. The test is now being augmented as follows:

"…if, <u>for the twelve-month period ending on the date on which the entitlement to the dividends is determined</u>:
i) <u>the beneficial owner has been a company that was a resident of the other Contracting State or of a qualifying third state.</u> The term "qualifying third state" means a state that has in effect a comprehensive convention for the avoidance of double taxation with the Contracting State of the company paying the dividends that would have allowed the beneficial owner to benefit from a rate of tax on dividends that is less than or equal to 5 percent; and
ii) <u>at least 10 percent of the aggregate vote and value of the shares of the payor of the dividends was owned directly by the beneficial owner or a qualifying predecessor owner</u>. The term "qualifying predecessor owner" means a company from which the beneficial owner acquired the shares of the payor of the dividends, but only if such company was, at the time the shares were acquired, a connected person with respect to the beneficial owner of the dividend, and a resident of a state that has in effect a comprehensive convention for the avoidance of double taxation with the Contracting State of the company paying the dividends that would have allowed such company to benefit from a rate of tax on dividends that is less than or equal to 5 percent. For this purpose, a company that is a resident of a Contracting State shall be considered to own directly the shares owned by an entity that:

A) is considered fiscally transparent under the laws of that Contracting State; and
B) is not a resident of the other Contracting State of which the company paying the dividends is a resident;

in proportion to the company's ownership interest in that entity;…"

The underlined limbs above comprise the basic elements of the "5% test" with the remaining limbs outlining certain explanations. It has been made significantly more restrictive in that there is now a 12 month requirement regarding "beneficial ownership" and "required holding".

Taking the latter firstly the 1997 treaty required the beneficial ownership of the voting stock of the payor company but this has now been extended to 10% of the vote *and value* of the shareholding concerned. It is possible that shares can have differing rights and may separate voting rights from, say, profit distribution rights and assets on a winding up for various commercial reasons. It may be a difficult and indeed cumbersome exercise to determine the shares with such value where there is more than one class of share in issue. Further this twelve month requirement may have an impact on corporate acquisitions in that a company in one Contracting State that acquires a company in another Contracting State may not avail of the 5% rate for 12 months after acquisition notwithstanding that dividends may be paid in that time. It is useful that in meeting the 12 month test that the company which is the beneficial owner of the dividend could have been resident in a third country with a comprehensive tax treaty with the US or a "qualifying predecessor owner" where it was connected with the beneficial owners and resident in a third country with a comprehensive tax treaty with the US. Further the clarification of holding shares through fiscally transparent vehicles is helpful. That said it would be far simpler for this twelve month test to be eliminated in the first instance. In addition and as noted earlier in this document, the treaty is unclear as to the meaning of a "comprehensive tax treaty" and it is presumed that this would be one with similar conditions to that in the 2016 Model treaty. If that is the case then it may be some time before the benefits of the resident in a third state and "qualifying predecessor owner" could be taken by dividend recipient companies.

Consideration should be given to removing the twelve month test ownership requirement or at least allowing a dividend to be paid during a twelve month period similarly to the assessment of whether a company is a parent of another company for the purposes of TCA97 s626B.

Further, it may be the case that financial trading and similar vehicles may not be in a position to meet this twelve month test, given the very nature of their activities, and would have the additional tracking burden as to whether the 5% or 15% withholding tax rate was to apply. This would have an adverse effect on such entities given the returns which are already subject to the volatility or otherwise of the markets would also have to manage the uncertainty regarding the application of a withholding tax.

It is curious that the reference to "*The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations. This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid"* is not present in the model treaty dividend article in para 2 as is the case in the current treaty. It may be that this may form part of the Mutual Agreement procedures but it would be preferable if this paragraph were to remain within the treaty article in the interests of certainty of application.

The addition of para 3 is a welcome one as it recognises the tax status of a pension fund and provides a withholding tax exemption on dividends in such instances. The 2006 Model's TE notes *"Paragraph 3 provides that dividends received by a pension fund may not be taxed in the Contracting State of which the company paying the tax is a resident, unless such dividends are derived from the carrying on of a business, directly or indirectly, by the pension fund or through an associated enterprise. For these purposes, the term "pension fund" is defined in subparagraph 1(k) of Article 3 (General Definitions). The rule is necessary because pension funds normally do not pay tax (either through a general exemption or because reserves for future pension liabilities effectively offset all of the fund's income), and therefore cannot benefit from a foreign tax credit. Moreover, distributions from a pension fund generally do not maintain the character of the underlying income, so the beneficiaries of the pension are not in a position to claim a foreign tax credit when they finally receive the pension, in many cases years after the withholding tax has been paid. Accordingly, in the absence of this rule, the dividends would almost certainly be subject to unrelieved double taxation"*. The point made in discussions on art4 regarding the absence of Collective Investment Undertakings from the model treaty is equally applicable in this instance.

Para 4 is not unlike the replacement to para 4 of the 1997 US treaty brought about by the 1999 amendment. Para 4 in the 2016 Model also confirms that the exemption in the abovementioned para 3 for pension funds will apply where the conditions outlined in para 4 are met. The TE to the 1997 treaty with the US notes that *"The denial of the 5 percent withholding rate at source to all RIC and REIT shareholders, and the denial of the 15 percent rate to all but small individual shareholders of REITs is intended to prevent the use of these entities to gain unjustifiable source taxation benefits for certain shareholders resident in the other Contracting State. For example, a corporation resident in Ireland that wishes to hold a diversified portfolio of U.S. corporate shares may hold the portfolio directly and pay a U.S. withholding tax of 15 percent on all of the dividends that it receives. Alternatively, it may acquire a diversified portfolio by purchasing shares in a RIC. Since the RIC may be a pure conduit, there may be no U.S. tax costs to interposing the RIC in the chain of ownership. Absent the special rule in paragraph 2, use of the RIC could transform portfolio dividends, taxable in the United States under the Convention at 15 percent, into direct investment dividends taxable at only 5 percent".* The paragraph now includes a meaning of "diversified" which was not present in the current treaty and therefore puts its meaning beyond doubt by as follows:

"…a REIT shall be "diversified" if the value of no single interest in real property (immovable property) exceeds 10 percent of its total interests in real property (immovable property). For the purposes of this rule, foreclosure property shall not be considered an interest in real property (immovable property). Where a REIT holds an interest in a partnership, it shall be treated as owning directly a proportion of the partnership's interests in real property (immovable property) corresponding to its interest in the partnership".

This may bring about the position that taxpayers may have taken a different view in connection with the meaning of "diversified" and the question arises as to whether that view could be "grandfathered". For example, if one property held by the REIT constituted say 12% as opposed to 10% of the REIT's total interest in real property; that may not have been an unreasonable

presumption in the past and should be allowed continue. Indeed, it would be preferable if such definition were to be excluded as in the 1997 treaty such that there would be no change in the status quo.

Consideration to be given to the need to exclude the meaning of "diversified" in para 4 or at least clarification that it only be applied for REITs set up after the treaty comes into force.

Para 7 has been amended to ensure that the term dividends does not include distributions treated as gains under the law of a Contracting State of which the company making the distribution is resident and in such instance Art 13 (gains) is to apply. From a US perspective, if that is to be the case then withholding can apply under Art 13 without the benefit of the 5/15% rates allowed by Art 10. We understand that this may refer to the situation in the US where some distributions are treated for US tax purposes as a return of a portion of a shareholders' original investment (i.e. a return of capital). For example, this may occur when there is a change in the capital structure of a company. For U.S. income tax purposes, we understand that the return of capital portion of the distribution is non-taxable and treated as a reduction in the tax basis of the shares of the U.S. shareholders. Once the tax basis is exhausted, it is treated as a capital gain in the US. Therefore consideration to be given to allowing the reduced withholding rates in such instance.

Further, the 1997 protocol to the US-Ireland treaty clarifies that for the purposes of art10(5) thereof that *"the term "dividends " shall not include interest which, by reason of the fact that it was paid to a non-resident company, is treated as dividends under the domestic laws of either Contracting State, to the extent that such interest does not exceed the amount which would be expected to be paid between independent parties dealing at arm's length"*. Tax Briefing 45 of 2001 implies that interest which is regarded as a distribution under s130(2)(d)(iv) TCA97 is within the definition of "dividends" for the purposes of the US treaty and indeed appears to be the practice adopted as a result. Therefore, clarity should be brought about in this treaty negotiation to preserve the position. It would appear from art10(7) of the 2016 Model as currently written that the intention is that the status quo is preserved.

Consider clarification in connection with the meaning of dividends and interest.

Art10(10) of the 2016 Model, like art 10(7) of the current treaty, allows the US to impose its branch profits tax in a company which is Irish resident. The latter treaty allowed the tax to be imposed at a rate not exceeding 5% where certain conditions were met. Art10(10) of the 2016 Model brings about a similar 12 month test to that brought about for dividends and discussed above where this lower rate is to be applied. This means that if a company carries on its business through a branch in Ireland then it will not qualify for a reduction in branch profits tax for the first 12 months of residency. In contrast to dividends, companies may not be able to dictate the timing of the branch profits tax so consideration should be given to removing this provision.

Consideration to be given to removing the 12 month test for branch tax given that companies may not be able to dictate the timing of the branch profits tax.

Revision of LOB in Dividend Article

There are a number of tests outlined in Art22 (Limitation on Benefits) which seek to deny treaty benefits if the conditions of each test are not met. Some of these tests include a base erosion limb which requires that less than 50% of tax deductible payments must be made to a permissible list of recipients. With regard to the derivatives benefits test, this list of recipients centres around the concept of an "equivalent beneficiary" which is defined in Art22 and forms part of the ownership and base erosion elements of the derivative benefits test in Art22(4). As will be seen from discussions below on the LOB article, the inclusion of base erosion test within the derivative benefits provision is new, when compared to the current treaty, and brings about additional complexity. It is for that reason that the removal of the base erosion test from provisions, other

than the ownership provision in the LOB (which is within the current treaty), from the LOB article is suggested. In such instance then this exception in the Dividends article would have to be revisited.

The detail of Art22 is described below under the commentary on same however Art10(6) provides that if some of the conditions of the derivative benefits test are not met when dealing with dividends, treaty benefits will still apply with respect to dividends but at the highest rate of withholding to which the company's resident owners would be entitled. The tests are the rate comparison tests such that if the resident had received the dividend income directly, the resident would be entitled under such convention, a provision of domestic law or any other international agreement, to a rate of tax that is less than or equal to 5% or 15% (being the dividend rates applicable under the 2016 Model). In addition, the definition of "equivalent beneficiary" in the 2016 Model in Art 22(7)(e)(i)(B) has been modified to allow individual shareholders to be treated as companies for purposes of the rate comparison test with respect to dividends, provided that the company seeking to qualify under derivative benefits has sufficient substance through the conduct of an active trade or business in its residence country to indicate that the individual shareholders are not simply routing income through a corporate entity in order to benefit from the lower company rate. As such, a company may qualify for a 5% rate even if its owners are individuals that would only qualify for a reduction in tax to 15% if they received dividends directly.

If the base erosion test were to be removed from provisions of the LOB, other than the ownership provision as is the case under the Current Treaty, then art10(6) would have to be revisited. Consideration should be given to adopting the current treaty's derivative benefit provision given its simpler approach.

Article 11 – Interest

It is to be noted that para 5 of the protocol to the Current treaty notes that "*With reference to Article 10 (Dividends). For the purposes of paragraph 5, the term "dividends " shall not include interest which, by reason of the fact that it was paid to a non-resident company, is treated as dividends under the domestic laws of either Contracting State, to the extent that such interest does not exceed the amount which would be expected to be paid between independent parties dealing at arm's length.*" It is assumed that such a provision would be included in any renegotiated treaty and indeed the approach taken in TB45 would continue to apply to the renegotiated treaty with the US.

Renegotiated treaty should include similar provisions to that in the 1997 protocol to the current treaty.

The 2016 Model introduces new paragraphs under 2 and 3 in Art11. Art11(2) provides a number of anti-abuse exceptions to the source-country exemptions provided for under paragraph 1.

Art 11(2)(a) and (b) are not present in the Current Treaty but deal with "contingent interest". Subparagraph (a) provides for interest arising in [Ireland] 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. Any such interest may be taxed in [Ireland] according to the laws of [Ireland]. If the beneficial owner is a resident of the US, the highest rate at which the interest can be taxed is 15%. Subparagraph (b) refers to contingent interest arising in the US of a type that does not qualify as portfolio interest under U.S. domestic law. As with (a), the maximum tax on such interest is 15% if the beneficial owner of same is a resident of the US. These are therefore exceptions to the recipient State taxation. The exceptions above can effect taxing rights on profit participating notes allowing taxation in both states but Ireland has a number of domestic exceptions where they apply.

Art11(2)(c) impacts the ability to claim treaty reductions in withholding tax for payments from related parties for interest if the beneficial owner of the payment benefits from a STR with respect to the payment, as discussed under the commentary on Art 3. The key point here is that it is not sufficient that the resident benefit from an STR but rather that the resident so benefit "with respect to interest" in its Contracting State. The comments regarding STRs in Art 3 apply in this instance also.

Art11(2)(d) deals with the denial of treaty benefits for US withholding taxes on US sourced interest paid by US companies that are "expatriated entities", as discussed under the commentary on Art 10. The comments there apply in this instance also.

Art11(2)(e) includes a new rule that would allow a treaty partner to tax interest arising in that country in accordance with domestic law if the interest is beneficially owned by a connected person that benefits from "notional interest deductions" (NID). Ireland does not give notional interest deductions and as such should not affect Ireland's position. That said, other countries do allow such deductions and could impact on the future of transactions between Ireland and those States if there treaties were to be amended.

Subparagraph (f) deals with benefits which are allowable under the Headquartered companies' test which is newly introduced as part of the LOB in Art22 of the 2016 Model. It provides that interest arising in a Contracting State [Ireland] and beneficially owned by a resident of the other Contracting State [US] that only meets the headquarters companies' test of the LOB provision may be taxed in the source at a rate not exceeding 10%. The headquartered companies test is discussed below in the commentary on Art 22. The comments there apply equally in this instance

Subparagraph (g) contains a provision for interest that is an excess inclusion with respect to a residual interest in a real estate mortgage investment conduit may be taxed by each Contracting State in accordance with its domestic law. This provision is not in the Current Treaty but is contained in the 2006 Model and the TE notes that without 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.

Art 11(3) introduces a similar clause for interest, to that for dividends in Art 10(6) which provides that if some of the conditions of the derivatives test in the LOB Art are not met when dealing with interest, treaty benefits will still apply with respect to interest but at the highest rate of withholding to which the company's resident owners would be entitled. The comments in that section apply equally here.

Article 12 – Royalties

Art 12 provides for new additions to the royalties article, in line with those previously discussed for interest and dividends, as follows:

Art 12(2)(a) limits treaty benefits in the case of payments from related parties for royalties if the beneficial owner of the payment benefits from a STR with respect to the payment. Art12(2)(b) deals with inversions and denies treaty benefits for US sourced royalties paid by US companies that are "expatriated entities". The comments made earlier in art10 regarding expatriated entities and art3 regarding STRs apply equally for this article.

Art 12(3) provides that if some of the conditions of the derivatives test in the LOB Article are not met when dealing with royalties, treaty benefits will still apply with respect to royalties but at the highest rate of withholding to which the company's resident owners would be entitled. This is similar to the provision brought about for dividends in art10(6) and the comments thereon apply here also.

Subparagraph 6 is also a new introduction that is not contained in the Current Treaty and states that *"Royalties shall be deemed to arise in a Contracting State when they are in consideration for the use of, or the right to use, property, information or experience in that Contracting State."*

Arguably, this is more clarification than amendment but is welcomed as it is helpful in recognising items which are regarded as valuable and for which cross-border charges can be made.

Article 13 – Gains

Subparagraph 2(c)(ii) in the 2016 Model includes "an interest in a partnership or trust to the extent that the assets of the partnership or trust consist of real property situated in [Ireland] or of shares referred to in clause (i) of this subparagraph" in the meaning of real property. This provision is contained in the 2006 Model but not in the current Treaty.

Art 13(5) provides "Gains derived by an enterprise of a Contracting State from the alienation of containers (including trailers, barges and related equipment for the transport of containers) used for the transport of goods or merchandise shall be taxable only in that Contracting State, unless those containers are used for transport solely between places within the other Contracting State." This provision is absent from the Current Treaty but is contained in the 2006 Model.

A new paragraph 7 has been added to Art 13 to provide that, when an individual is subject to an exit tax as a result of ceasing to be a resident of a Contracting State, that individual may elect to be treated as if he or she had disposed and reacquired such property for its fair market value immediately before ceasing to be a resident.

Article 14 – Income from Employment

Article 14 of the 2016 Model is contained in Art 15 of the Current Treaty. However, Art 14 of the Current Treaty (Independent Personal Services) contains the following provisions:

Income derived by a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State, unless he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities. If he has such a fixed base, the income may be taxed in the other State but only so much of it as is attributable to that fixed base.

The term "professional services" includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

The above does not explicitly appear in the 2016 Model, however, as discussed under the commentary on Art 3, the definition of "enterprise of a contracting state" applies to the carrying on of any business and the term "business" includes the performance of professional services and of other activities of an independent character.

The taxation of an "enterprise of a contracting state" under the Business Profits (Art 7) of the 2016 Model achieves the same outcome of Art 14 in the Current Treaty. The renegotiation of the treaty would have to consider if Art 3 is to be updated in line with the 2016 Model, or if Art 14 of the Current treaty is to be adopted.

The comparison of Art 14 of the 2016 Model to Art 15 of the Current Treaty does not contain any variations.

Article 15 – Directors Fees

The definition of the income subject to the article remains the same in the 2016 Model when compared with the Current Treaty. However, Art 16(2) of the current Treaty contains the following provision which is absent from the 2016 Model: "Directors' fees and other similar payments shall be deemed to arise in the Contracting State in which the company is resident except to the extent that such fees are paid in respect of attendance at meetings held in the other Contracting State". Such a provision holds importance for large multinational companies who may have senior executives working between the US and Ireland. The exemption for income arising to directors in respect of meetings which are not held in Ireland is a more attractive and straightforward relief than operating a credit to cover the double taxation of such income.

The provisions in Article 16(2) of the current treaty should be inserted into the renegotiated treaty as part of the renegotiations.

Article 16 – Entertainers and Sportsmen

The gross receipts threshold for such activities to be subject to source-based taxation is raised from $20,000 to $30,000 or the Irish equivalent of same for the tax year in question. Given the minority impacted by this change we do not see this is proposal as having a significant impact.

Article 17 – Pensions, Social Security, Annuities, Alimony and Child Support

Art 17 of the 2016 Model is comparable to Art 18 of the Current Treaty. The provisions contained in both are comparable with the addition on paragraph 2 to Art 17 of the 2016 Model, as follows:

> *(a)Where an individual who is a resident of a Contracting State is a member or beneficiary of, or participant in, a pension fund established in the other Contracting State, income earned by the pension fund may not be taxed as income of that individual, unless, and then only to the extent that, it is paid to, or for the benefit of, that individual from the pension fund (and not transferred to another pension fund established in that other Contracting State in a transfer that qualifies as a tax-deferred transfer under the laws of that other Contracting State). In such case, the provisions of paragraph 1 of this Art shall apply.*
> *b) Where a citizen of the United States who is a resident of _____ is a member or beneficiary of, or participant in, a pension fund established in _____, the United States may not tax the income earned by the pension fund as income of the individual unless, and then only to the extent that, it is paid to, or for the benefit of, that individual from the pension fund (and not transferred to another pension fund established in _____ in a transfer that qualifies as a tax-deferred transfer under the laws of _____). In such case, the provisions of paragraph 1 of this Art, which generally is subject to paragraph 4 of Art 1 (General Scope), shall apply.*

In addition, Art 17 of the 2016 Model refers to a "pension fund" throughout, with the Current Treaty using the term "pension plan". Pension fund is a newly defined term under Art 3 of the 2016 Model, as discussed earlier. The above amendment provides that where a resident of a Contracting State [US] is a participant in a pension fund in the other Contracting State [Ireland], the residence state will not tax income derived by the pension fund until the income is paid to the beneficiary of the pension fund. The provision also allows the resident to roll over its beneficial interest in a pension fund to another pension fund established in the other Contracting State [Ireland] if such transfer qualifies as a tax-deferred transfer under the laws of that other Contracting State [Ireland]. There is a similar provision with respect to citizens of the United States who are resident in the other Contracting State [Ireland].

The above are welcomed inclusions in the treaty and will avoid instances of double taxation for US residents on assignment to Ireland for example which is a positive position.

Article 18 – Pension Funds

The content of Art 18 of the 2016 Model is comparable to Art 18 of the Current Treaty. Subparagraph 3 is a new addition when compared to the Current Treaty but this content was previously included in the 2006 Model. The TE notes that this section provides U.S. tax treatment for certain contributions by or on behalf of U.S. citizens resident in the other Contracting State to pension funds established in the other Contracting State that is comparable to the treatment that would be provided for contributions to U.S. funds.

This is also a welcomed addition to the treaty and will provide more favourable treatment for US/Irish staff undertaking secondments or assignments abroad.

Article 19 – Government Service

There are no changes impacting the Current Treaty under this Article.

Article 20 – Students and Trainees

Subparagraphs 2 and 3 are new introductions in comparison to the Current Treaty however both paragraphs are contained in the 2006 Model with the only change being that the threshold for personal services that are exempt from tax in the state of temporary residence is raised from $9,000 to $10,000. This is welcome.

Article 21 – Other Income

It should be noted that Art 21 of the Current Treaty covers "offshore exploration and exploitation activities". There is no separate article for same under the 2016 Model, however, the definition of a PE under Art 5 of the 2016 Model includes "*exploration or exploitation of the sea bed and its subsoil and their natural resources*" under the types of activity constituting a PE. As such, the rules under the 2016 Model for PEs (as discussed under the commentary for Art 5) govern these activities and as such a PE will not be constituted unless the activity lasts for more than 12 months (taking account of the new aggregation rules for connected person).

Art 21 of the 2016 Model is comparable to Art 22 of the Current Treaty. The 2016 Model introduces paragraph 2 to the article, which contains the provisions dealt with previously for a STR and payments from "expatriated entities". Paragraph 2(a) impacts the ability to claim treaty benefits for payments from connected persons for a guarantee fee arising in and characterized as other income by [Ireland] if the [US] beneficial owner of the payment benefits from a STR with respect to the payment, as discussed under Art 3. Paragraph 2(b) deals with the denial of treaty benefits for US sourced guarantee fees characterised as other income that are paid by US companies that are "expatriated entities", as discussed under Art 10.

Article 22 – Limitation on Benefits

The 2016 Model places significant additional restrictions on the tests that are currently contained in the LOB article of Ireland-US Treaty. It is likely that the 2016 Model will make it difficult for many companies to qualify for treaty benefits and, at a minimum, will add additional complexity and uncertainty to nearly all companies' (including companies which benefit under the current treaty) determinations of whether they qualify for treaty benefits.

The article provides that no treaty benefits are available unless the definition of a "qualified person" is met or as provided in Art 22. In general, the "qualified person" test is to be satisfied *at the time when the benefit would be accorded* whereas the current Treaty the test is *for a fiscal year*. The test is modified under Art 22(2)(f)(i) where the benefit is sought thereunder and requires the person is a qualifying person on at least half of the days of any 12 month period that includes the date when the benefit otherwise would be accorded. A similar time test applies under para 4 for art 22 in respect of the derivative benefits test which is discussed further below. The following considers each of the tests contained in Art 22 of the 2016 Model.

a. <u>Stock exchange test</u>

The current treaty applies a stock exchange test if the shares of the company are regularly traded on a recognised stock exchange or are 50% held directly or indirectly by such companies or qualified governmental entities. Under the 2016 Model the stock exchange test in art22(2)(c) will be met where the principal class of shares and any disproportionate class of shares are regularly traded on a recognised stock exchange (wherever located) and either (1) the location of that stock

exchange is located in the Contracting State where the company is resident *or* (2) if the company's primary place of management and control is in the resident state. Under the current treaty, the location of recognised stock exchange is widely defined and includes *"the Irish Stock Exchange and the stock exchanges of Amsterdam, Brussels, Frankfurt, Hamburg, London, Madrid, Milan, Paris, Stockholm, Sydney, Tokyo, Toronto, Vienna and Zurich"* and we would argue that such exchanges should be included in the renegotiation of the current treaty in line with the 2016 Model. Therefore the Model 2016 test is a substantial change bringing about additional restrictions which will likely make it more difficult for some listed companies to qualify for treaty benefits. In particular a number of publicly quoted companies are "principally" traded on the UK stock exchange as opposed to either the Irish or US exchanges. Therefore, if the location of the stock exchange on which the shares of the company are primarily traded test is to remain within a renegotiated treaty then consideration should be given to reverting to that already in the current treaty or at least extending this to stock exchanges within the UK as well as elsewhere in the EU. The reference to "disproportionate class of shares" is included in the current treaty within the definition of "principle class of shares". However the meaning of the term in the 2016 Model has been extended to include "*in the case of a trust, any class of beneficial interests in such trust".*

In addition, the reference to "primary place of management" is curious and could bring about additional complexity. This is defined in Art22(7)(d) as follows:

"…a company's "primary place of management and control" is in the Contracting State of which it is a resident only if:

i) the executive officers and senior management employees of the company exercise day-to-day responsibility for more of the strategic, financial and operational policy decision-making for the company and its direct and indirect subsidiaries in that Contracting State, and the staff of such persons conduct more of the day-to-day activities necessary for preparing and making those decisions in that Contracting State, than in any other state; and

ii) such executive officers and senior management employees exercise responsibility for more of the strategic, financial and operational policy decision-making for the company and its direct and indirect subsidiaries, and the staff of such persons conduct more of the day-to-day activities necessary for preparing and making those decisions, than the officers or employees of any other company;…"

The reference to "day to day responsibility" for "*strategic, financial and operational policy decision-making for the company and its direct and indirect subsidiaries in that Contracting State"* is curious and guidance would be necessary on same. In the absence of same, the test contained in the 2016 Model for the primary place of management and control is onerous and does not take into account the decentralised structures under which a number of multinational groups operate whereby staff members could be located out of Ireland in assisting with the running of the Irish company. The key and strategic decisions will always have to be made in country of residence. While the motivations for the provisions in targeting expatriated entities can be appreciated, this provision goes beyond that and as a result genuine Irish headquartered publically listed companies may be unable to avail of treaty benefits.

We understand from speaking to taxpayers that the practical implications of primary place of management and control test is that many jobs may be lost in the US as groups attempt to relocate their current decentralised model from the US in order to fall within the wording of this stringent provision. A further concern is that the stock of listed companies will be moved from the US stock exchange to the Irish stock exchange and the US capital markets may suffer as a result.

We have received feedback from one concerned taxpayer who views the primary place of management and control test as too onerous to meet based on their current structure and raised the possibility of moving the tax residence of the company to the UK as Ireland is viewed as being at a competitive disadvantage if the terms of the renegotiated treaty were to be agreed based on the 2016 Model. This is not a unique view. It is ironic that the double tax treaty, the purpose of which is the avoidance of double taxation, could be viewed by companies as an incentive to move their tax residency from Ireland in order to rely on a different tax treaty.

Indeed, there are key concerns from a funds industry perspective in that similar to Irish regulated funds, Irish Exchange traded funds are ultimately managed and controlled by their board of directors which ensures that the company is resident in Ireland. However, such ETFs engage third parties e.g. certain management companies to provide certain support and additional management services to them. They may arrange a regulated investment manager who looks after managing the financial assets of the ETF in accordance with its investment policy. This investment manager may be an Irish company but in most cases will be based outside Ireland and will be regulated in its home country. On that basis it may be difficult to adequately confirm the location of "primary place of management and control".

It would be preferable if the current treaty requirement regarding quoted companies could be maintained. If the location of the stock exchange on which the shares of the company are primarily traded test is to remain then consideration should be given to extending this to stock exchanges within the UK as well as elsewhere in the EU. Consideration should be given to removing the "primary place of management test" given the levels of uncertainty it may bring about.

Art 22(2)(e)(ii) of the current treaty allows a company to be owned at least 50% directly or indirectly by listed companies or by certain governmental entities. This provision is significantly amended in the 2016 Model under Art 22(2)(d). To meet the "subsidiary of a quoted company" test under the 2016 Model at least 50% of the aggregate vote and value of the shares and any disproportionate class of shares in the company must be held directly or indirectly by 5 or fewer listed companies which are entitled to the benefits under the treaty. Further, in the case of indirect ownership, intermediaries in the corporate chain must be resident of the contracting state from which a benefit under the treaty is being sought or a Qualifying Intermediate Owner (QIO) at each level. This is a similar requirement to that outlined at p26 of the BEPS Action 6 report but it is noted at p28 that "*…some States consider that, in the case of publicly-listed companies, the condition that each subsidiary in the chain must be a resident of either Contracting State is not necessary in order to prevent treaty shopping; these States therefore prefer to omit that additional condition".*

A QIO is defined in art 22(7)(f) as an intermediate owner that is either a resident of a state that has a comprehensive income tax treaty in force with the source country containing rules addressing STRs and certain notional deductions that are analogous to the rules in the 2016 treaty under art3(1)(I) and art11(2)(e) <u>or</u> a resident of the same Contracting State as the company seeking treaty benefits and qualifying under art22(2)(d), (f) or para 4 i.e. generally, a 50% subsidiary of a quoted company(ies) or a company or other entity which is 50% owned by individuals, governmental agencies, quoted companies and pension funds. As such, for a third-country intermediate owner, this test cannot be met until treaties are renegotiated to capture rules addressing special tax regimes and notional deductions. A "hypothetical" test could be inserted such in the renegotiated treaty such that the benefits would be granted thereunder if the test in the Model 2016 were to be "hypothetically" included in the third countries' treaties with the US but that would bring about significant uncertainty as to its application. If such test is to remain within a renegotiated treaty then it should not become in force until a substantial number of treaties have been renegotiated by the US with significant treaty partners. The current treaty looks to the ownership requirements as being met by reference to the status of the last persons in the change of ownership. The Technical Explanation to the current treaty notes "*Ownership by qualified persons may be indirect, but in cases of a chain of ownership, the ownership test must be satisfied by the last owners in the chain. In general, this requires that intermediate owners be disregarded and that ownership be traced to a person that is entitled to benefits without reference to its owners (such as a publicly traded company …)"*. Therefore the advent of a QIO requirement is a substantial change bringing additional complexity which may disapply the benefits of the treaty where it has heretofore applied in bona fides circumstances.

The advent of a QIO requirement is a substantial change bringing additional complexity and may disapply the benefits of the treaty where it has heretofore applied; indeed the BEPS Action 6 report allows for such requirement to be omitted. Further, given the length of time involved in renegotiating income tax treaties, the practical effect of these intermediate ownership rules is that third-country intermediate owners will prevent treaty qualification. It is therefore suggested that the QIO condition be excluded from the renegotiated treaty.

However the test does not end there in that to satisfy the subsidiary of a quoted company test, there is also a **base erosion test** which must be satisfied which is not present in the current treaty. The base erosion test in the 2016 Model now applies to the subsidiary of a quoted company test (art22(2)(d)), the ownership test (art22(2)(f)), the derivative benefits test (art22(4)), and the newly introduced headquartered companies test (art22(5)). The current treaty only applies a base erosion test where the ownership test is in point so the 2016 Model outlines a significant and negative shift in terms of complexity. It is to be noted that the BEPS Action 6 report does not include a base erosion test as part of the subsidiary of a quoted company provision.

The base erosion test in the 2016 Model looks to the gross income of the company *and* the tested group which is a significant change to the test and brings about additional complexity and indeed uncertainty given that the company cannot constantly be aware of the activities of the group; it will be recalled that the test of "qualified person" in this instance is the time at which the benefit is accorded. Such provision is not within the BEPS Action 6 report in any event. The latter is defined as the resident of a Contracting State that is applying the test and any company that participates as a member with that resident in a tax consolidation, fiscal unity or similar regime that requires members of the group to share profits or losses; or shares losses with the tested resident pursuant to a group relief or other loss sharing regime in the taxable year. The 2016 Model significantly changes the definition of "*gross income*" by providing that it "*…means gross receipts as determined in the person's Contracting State of residence for the taxable year that includes the time when the benefit would be accorded, except that where a person is engaged in a business that includes the manufacture, production or sale of goods, "gross income" means such gross receipts reduced by the cost of goods sold, and where a person is engaged in a business of providing non-financial services, "gross income" means such gross receipts reduced by the direct costs of generating such receipts, provided that:*

i) except when relevant for determining benefits under Article 10 (Dividends) of this Convention, gross income shall not include the portion of any dividends that are effectively exempt from tax in the person's Contracting State of residence, whether through deductions or otherwise; and

ii) except with respect to the portion of any dividend that is taxable, a tested group's gross income shall not take into account transactions between companies within the tested group".

Indeed, the current treaty requires a 4 year average whereas the model looks only to the year in which the benefits are sought. The tax deductible payments to be reviewed under the 2016 Model do not exclude finance payments to US/Irish banks (except for the case of headquartered companies – discussed below) as in the case of the current treaty's base erosion test which is well understood; it must be recalled that in the current treaty the base erosion test only applied to the basic ownership test and the Model 2016 applies the base erosion test to

- The subsidiary of a quoted company test,
- The ownership test
- The Derivative Benefits test and
- The headquarters test

There is an exclusion for intra group transactions for the case of a tested group and there are a number of different types of payee to consider in determining whether the tax deductible

payments made do not exceed 50% of gross income or tested group income. The types of payees to consider in the test for the subsidiary of quoted company are as follows:

i. to persons that are not individuals, governmental entities, pension funds, or publicly traded companies (entitled to the benefits under Art 22),
ii. to connected persons that benefit from a special tax regime with respect to the deductible payment; or
iii. for interest payments, to connected persons that benefit from certain notional deductions

Under (i) above, publicly traded companies are allowable recipients. However, subsidiaries of publicly traded companies are disallowed as recipients, meaning payments to a local operating subsidiary of a publicly traded company could cause the tested company to fail the base erosion test (as could payments to a privately owned company).

A similar base erosion test is contained in the ownership test (art 22(2)(f)), the derivative benefits test (art 22(4)), and the newly introduced headquartered companies test (art 22(5)). It is of note that the derivatives benefit test outlined on p30 of the BEPS Action report does not contain similar references to special tax regimes and notional deductions as is the case in this instance.

These base erosion tests will have a severe impact on treaty qualification where such tests may not have applied in the past. In particular the tests provide that companies that would qualify for treaty benefits (under a subsidiary of publicly traded company test, an ownership/base erosion test, a headquarters company test, or a derivative benefits test) themselves are not permissible recipients of base-eroding payments. The BEPS Action 6 report does not contain a base erosion test as part of the subsidiary of a publicly quoted company provision or derivative benefits and it is therefore suggested that this should be removed from the renegotiated treaty. Further, the inclusion of a "test group" concept brings about additional complexity and uncertainty to the base erosion test and is not part of the Action 6 BEPS report in any event.

b. Ownership Test

The ownership test (which applies to a person other than an individual) under the current treaty is included at Art 23 para 2(c) and under the 2016 Model is in Art 22 para(2)(f). This allows a person to be a qualified person where shares and other beneficial interest representing 50% of the vote and value of certain shares in that person are owned by other qualifying persons. Under this test in the 2016 Model the resident shall be a qualified person at the time when the benefit would be accorded and on at least half of the days in any 12 month period that includes the date when the benefit would be accorded.

Unlike the current treaty, which only requires that the last owners in the chain are owned by qualifying persons or US residents there is a new requirement for each intermediate owner to be a QIO in the case of indirect ownership. In order to meet the test under the 2016 Model the 50% ownership must be held by individuals, governmental entities, pension funds, or publicly traded companies (entitled to the benefits under Art 22). The comments made earlier in relation to QIOs and base erosion requirements here are the same as those outlined above for the subsidiary of a quoted company discussed above and apply equally here.

In the context of Irish regulated funds this would be a fundamental change to the LOB and would have severe negative consequences as a number of funds would rely on the existing ownership test e.g. US, Irish investors to achieve treaty access.

The comments made earlier in relation to QIOs and base erosion requirements here are the same as those outlined above for the subsidiary of a quoted company discussed above together with funds and apply equally here.

c. Active trade or business test

This test is a particularly important one for private companies which cannot avail of the quoted company or derivatives benefits aspects of the LOB provisions but also relevant to quoted companies looking to qualify certain subsidiaries for this test. The "active trade or business" provision is contained in art22(3) and allows a resident of a Contracting State access to the benefits of the treaty with respect to an item of income regardless of whether the resident is a qualified person if the resident is engaged in the active conduct of a trade or business in that Contracting State, and the income derived from the other Contracting State emanates from, or is incidental to, that trade or business.

The wording under the current treaty is that the income is "in connection with or incidental to" the trade or business, which is similar to the wording adopted in Action 6 BEPS report, whereas the 2016 Model includes where "the income *emanates* from or is incidental to". There are no definitions of these terms included however the preamble to the 2016 treaty notes that the wording *"emanates from or is incidental to"* require a factual connection between an active trade or business in the residence country and the item of income for which benefits are sought. In addition, the provision allows activities to be attributed from connected persons and is introduced to address a concern that third-country residents were currently allowed to treaty shop through an entity that has an active trade or business in a treaty partner with respect to income, in particular intra-group dividends and interest, that does not in fact have a nexus to the activities in the treaty partner. Given that the OECD has agreed a particular wording in relation to the application of the test then it is suggested that that wording be adopted.

The wording used regarding the application of the test in Model 2016 differs from that used in BEPS Action 6 report then it is suggested that that agreed wording be adopted as part of the renegotiated treaty.

The term "trade or business" has not been defined and indeed a Technical Explanation (TE) is not available at the time of writing in connection with the 2016 Model. The TE to the current treaty notes that *"In general, a trade or business will be considered to be a specific unified group of activities that constitute or could constitute an independent economic enterprise carried on for profit. Furthermore, a corporation generally will be considered to carry on a trade or business only if the officers and employees of the corporation conduct substantial managerial and operational activities".* It is assumed that such clarification will remain as in in any forthcoming TE and should be considered as part of any negotiations.

The meaning of "active conduct of a trade or business" differs significantly from the current treaty and has been amended to exclude (i) operating as a holding company, (ii) providing overall supervision or administration of a group of companies, or (iii) providing group financing (including cash pooling). The inclusion of point (i) may be debateable depending on the level of activity concerned and indeed p38 of the OECD's BEPS Action 6 report notes *"Since a headquarters operation is in the business of managing investments, a company that functions solely as a headquarters company will not be considered to be engaged in the active conduct of a business…"* but points (ii) and (iii) can be very active and indeed very substantial endeavours and yet could conceivably be within the remit of the current LOB clause. Ireland traditionally has and will continue to promote itself as a centre of excellence for financial services hub and such exclusions from the active trade or business (where a company could not rely on other tests within the Model 2016 LOB clause) could have a significant negative impact on this. This is particularly so when points (i), (ii) and (iii) are not included in the OECD BEPS Action 6 report.

The proposed exclusion of group financing (including cash pooling) from the definition of an "active conduct of a trade or business" may have a significant impact on Ireland's ability to compete as a

centre of excellence for corporate treasury operations for groups with US operations. Many groups operate some form of centralised cash management structure which may include in-house banks, foreign exchange centres, and payment factories etc. Through these centralised treasury structures groups undertake activities like centralised lending, payment management, risk management (including liquidity, financial and credit risks), foreign exchange hedging and facilitate the implementation of group investment strategies. Centralised treasury centres also manage banking relationships on behalf of the group minimising overall administration and transaction costs which otherwise would arise where individual banking relationships are separately maintained by individual group operating entities. Therefore, centralised treasury operations can provide important economies of scale, as well as better terms and conditions negotiated with banks. These are especially desirable features in times of economic downturn and stringent cost cutting.

Furthermore, for short-term cash management, cash pooling is often the most effective way to optimize both excess and deficit cash positions within a group of companies. Intragroup cash pooling is an arrangement commonly used by groups to efficiently manage lending among members of the group by using surplus cash of some participating members of the cash pool to fund the operating requirements of other participating members without having to significantly draw down local bank credit facilities by one member of the group. The benefit of netting group deposits and borrowing through cash pooling can significantly reduce the need for external finance and combined interest cost for the group. Volume benefits can also arise where the cash pool header can negotiate better rates with banks than pooling participants could get on their own.

It should be noted that a number of MNE's strategically decided to house their finance/treasury operations outside the US to manage banking relationships and maintain close proximity to their business operations in a particular region (e.g. Europe or APAC). In this regard Ireland has traditionally been a European jurisdiction of choice for a number of commercial reasons including the availability of a skilled treasury workforce, the strong legislative framework that exists in relation to treasury transactions proximity to the EU capital markets and also the proximity of time zones for with an MNE group's European operations.

As highlighted above, there are clearly significant commercial benefits associated with the centralisation of group financing and cash pooling operations. Therefore, given that the activities of bone fide licenced banks are not specifically excluded for the purposes of applying the active trade or business test there should be no reason why the commercial activities of group financing operations should be specifically disadvantaged in this manner.

The difference in wording between the 2016 Model and the OECD BEPS report regarding the application of the provision in the first instance should be revised. The additional exclusions from active trade or business regarding (i) operating as a holding company, (ii) providing overall supervision or administration of a group of companies, or (iii) providing group financing (including cash pooling) brought about by the model are not included in the BEPS Action 6 report and should not be included in the final negotiated treaty.

The current treaty has a requirement for the activity generating the income to be "substantial" to the trade or business where the recipient resident has an ownership interest in the activity in the other State in determining whether the item of income concerned is "connected with or incidental to" the trade or business in the income recipient's state. The 2016 Model has a similar test (albeit without the ownership interest requirement) in determining whether the income derived from the Other State emanates from or is incidental to the trade or business. This "substantial" test has been extended in that it requires the comparison to be made to the same or complementary trade or business activity carried on by the resident or such connected person in the other Contracting State.

The 2016 Model notes that whether a trade or business activity is substantial it "shall be determined based on all the facts and circumstances" which is the case in the BEPS Action 6

report. This is similar to that contained in the Current treaty except the current treaty has certain "bright line" tests which look to previous years and determine, inter alia, the ratio of assets, income and payroll expense between the contracting States. The absence of such bright line tests should be considered for reinstatement in the renegotiated treaty to allow for the removal of subjectivity and uncertainty in the application of the active trade or business test.

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The ownership requirement attached to the "substantial" test in the 2016 Model applies for "connected persons" which is defined above under the commentary on Art 3 and as such a connected person would have an ownership interest similar to the provisions of the current treaty.

The preamble to the 2016 Model notes that the technical explanation of same (which is not yet available) will provide guidance on when an item of income, in particular an intra-group dividend or interest payment, is considered to emanate from the active conduct of a trade or business of a resident. It notes that an example that the Treasury Department is considering including in the technical explanation is *"dividends and interest paid by a commodity-supplying subsidiary that was acquired by a company whose business in the residence state depends on a reliable source for the commodity supplied by the subsidiary. Under this example, such dividends and interest would be considered to emanate from the active trade or business of the parent. Another possible example could involve dividends and interest paid by a subsidiary that distributes products that were manufactured by the parent company in its state of residence. In contrast, the mere fact that two companies are in similar lines of businesses would not be sufficient to establish that dividends or interest paid between them are related to the active conduct of a trade or business".* It can be seen that the provision in looking to connected parties in determining the application of the LOB can bring additional uncertainty to taxpayers and its revision for clarity purposes should be considered in the renegotiated treaty.

Derivative benefit test

This is contained in art22(4) of the 2016 Model and is similar conceptually at least to that of the art23(5) of the Current Treaty. The 2016 Model does not limit the geographic location of the equivalent beneficiary to members of the EU and NAFTA as is the case with current treaty. That said, it has brought about a "double timing" test in that the benefits of the treaty may be accorded to a non-qualified person if (i) at the time when the benefit would be accorded,[the 'immediate' rule] and (ii) on at least half of the days of a twelve-month period commencing or ending on the date when the benefit otherwise would be accorded [the 'look back' rule]. The LOB Art in the BEPS Action 6 report only contains the former and not the 'look back' rule. The inclusion of the 'look back' rule brings about additional complexity to an already complex provision and should be removed from the renegotiated treaty.

The inclusion of a "look back" rule as part of "double timing" test to the provision's application in the first instance should be removed given it is not part of the BEPS Action 6 report.

As well as owning 95% of the aggregate vote and value of the company's shares, 50% of any disproportionate shares must also be owned under the 2016 Model. The ownership must be held by 7 or fewer qualified persons of EU/NAFTA residents under the current treaty but this is changed to "*equivalent beneficiaries*" under the 2016 Model which provides that residents of any country potentially can be equivalent beneficiaries.

The test for "equivalent beneficiaries" is far more detailed and prescriptive than that outlined as part of the BEPS Action 6 report and therefore should be revisited with that in mind. If such approach is to be taken then the version agreed by the OECD should be that included in a renegotiated treaty. Further Action 6 does not include a Base erosion test as part of its application and therefore should be not be included as part of a renegotiated treaty.

As is the case with the "stock exchange test" discussed above, in the case of indirect ownership, each intermediate owner in the corporate chain must be a qualifying intermediate owner which is a new requirement and bring complexities if the intermediate owner is resident in a third state. An equivalent beneficiary is defined differently depending on whether the owner is a resident of a third State, a resident of the source State, or a resident of the same State as the tested company. It is also worth noting that Irish regulated funds make use of the derivative benefits test and the comments here equally apply.

i. Resident of a third State

A resident of a third State will qualify as an equivalent beneficiary if the person is a resident of a country that has an income tax treaty with the source State and such person qualifies for the benefits of such treaty by virtue of being an individual, a governmental entity, a publicly traded company, a pension fund etc or, when the benefit being sought is with respect to dividends or interest received from an affiliate, the third State company qualifies under its resident country's treaty with the source State under a provision equivalent to the headquartered companies provision (discussed in more detail below). In addition, the equivalent beneficiary must, in general, qualify for a similar rate under the tax treaty between its residence State and the source State with respect to the type of income for which treaty benefits are being claimed as the company relying on the derivative benefits test to claim treaty benefits (i.e. an Equivalent Rate analysis). Individuals resident in a third State will not qualify as equivalent beneficiaries if they are taxed in their State of residence on a remittance basis or on a fixed fee, 'forfeit,' or similar basis.

ii. Resident of the source State

The 2016 Model clarifies that a company relying on the derivative benefits test may have owners that are residents of the source State, provided that such persons in the aggregate do not own more than 25% of the tested company.

A company which is Irish resident and is 100% owned by a US quoted company (the source state in this instance) would not be in a position to meet the derivative benefit test. The benefits should be available under the current treaty. Of course, it may be possible that the company concerned would meet the alternative tests within the LOB Art but it would be preferable if such requirement were not included in the renegotiated treaty.

iii. Resident of the same State as the company seeking benefits

The resident company must qualify for the benefits of the treaty as an individual, a governmental entity, a publicly traded company, a charity or a pension plan or, if the benefit being sought is with respect to dividends or interest received from an affiliate, the resident company must qualify under the headquarters company test (discussed below) and must meet the Equivalent Rate analysis.

In addition to the ownership requirements above, there is also a base erosion test that has to be satisfied in order to meet the derivative benefits test. The comments made earlier in connection with the base erosion test apply equally here also. The options for payees to be considered as permissible to meet this test are, made to persons that are:

i. not equivalent beneficiaries;

ii. equivalent beneficiaries only by reason of being a headquartered company in accordance with art22(5);
iii. to equivalent beneficiaries that are connected persons and benefit from a STR with respect to the deductible payment; or
iv. with respect to a payment of interest, to equivalent beneficiaries that are connected persons and that benefit from certain notional interest deductions.

As such, even in cases where a company qualifying for treaty benefits as a headquarters company (discussed below) would be treated as a permissible owner of the tested company, the headquarters company would not be a permissible recipient of base-eroding payments.

The extension of the derivative benefits test beyond EU and NAFTA countries is a welcome addition to the derivative benefits test that exists in the current treaty. However, as reflected in the discussion above, the test is complex and can bring about uncertainty as to the application or not of the LOB in the first instance. This means that the derivatives benefit test may prove difficult for most companies to meet.

Adding to these limitations, persons seeking to qualify as equivalent beneficiaries in the context of a claim for benefits for intercompany dividends and interest may have to meet the onerous headquarters company test, depending on how this rule is interpreted. The definition of an equivalent beneficiary under paragraph 7 notes "*the resident is entitled to all the benefits of a comprehensive convention for the avoidance of double taxation between that state and the Contracting State from which the benefits of this Convention are sought, under provisions substantially similar to subparagraph (a), (b), (c) or (e) of paragraph 2 of this Article <u>or, when the benefit being sought is with respect to interest or dividends paid</u> by a member of the resident's multinational corporate group, the resident is entitled to benefits under provisions substantially similar to paragraph 5 of this Article[Headquartered companies]".* Given the underlined limb, it is unclear whether in the case of interest or dividends that a company is required to be a headquartered company in any case, or whether this is simply an additional way to qualify for benefits for intercorporate dividends and interest.

The new introductions under paragraph 6 of Art 10 (Dividends), paragraph 3 of Art 11 (Interest) and paragraph 3 of Art 12 (Royalties) for equivalent beneficiaries have previously been discussed and provide for situations where the "derivative" test under the new LOB Art will still be considered to be met when all the definitions of an *equivalent beneficiary* under same are not met.

d. <u>Headquartered Companies</u>

This is a new provision in the 2016 treaty that is not contained in the current treaty and it applies only to benefits with respect to dividends and interest. There are a number of tests to meet in order to be considered a headquartered company and there is also a base erosion test as previously described.

- the primary place of management and control is in resident state
- Multinational group consists of companies resident in and engaged in active trade in 4 countries which contributes to a least 10% of group gross income *(4 year averaging available)*
- Trades of group carried on in any state other than resident state generate less than 50% gross group income *(4 year averaging available)*
- Less than or 25% of such company's gross income is generated from the other contracting state *(4 year averaging available)*
- Subject to same income tax rules as someone who carries on active trade or business

The base erosion test is the same as that previously described, however for the headquartered company test there is an exclusion for finance payments to an unconnected bank in determining whether 50% of the deductible payments made are paid to qualifying payees. The payees are the same as those listed under the stock exchange test. While this test only applies for interest and dividends, in the case of interest, this benefit is limited to a 10% cap on withholding in the source state.

According to the preamble to the 2016 Model, a headquarters company is required to exercise *primary* management and control functions (and not just supervision and administration) in its residence country with respect to itself and its geographically diverse subsidiaries. However, In light of the restricted set of conditions, few companies are likely to meet this test.

e. Discretionary Benefits

In the current treaty the competent authorities of the US are required to determine that the operations are not established for treaty benefits. Under the 2016 Model it is the responsibility of the resident seeking benefits to demonstrate to the satisfaction of the competent authority a substantial nontax nexus to its Contracting State of residence and that obtaining treaty benefits were not one of the principal purposes of the establishment, acquisition, maintenance or conduct of the operations. This differs from the BEPS Action 6 report in that only the second test needs to be adhered to as the first is absent therefrom. The expression "substantial nontax nexus" is not defined in the 2016 Model and therefore its meaning is not clear at the time of writing; it would therefore have to form part of a Technical Explanation to the renegotiated treaty and a TE to the 2016 is not available at the time of writing. Given that this is an addition to an already agreed LOB as part of the BEPS Action 6 report it should not form part of a renegotiated treaty.

The application of a double test before discretionary benefits can be allowed to a person who would not otherwise qualify for such benefits where the Action 6 BEPS report only applies one needs to be reconsidered. The "substantial nontax nexus" test should not form part of a renegotiated treaty.

f. Pension Funds

A person will be regarded as a qualifying person if they are a resident, provided that,

i. If providing pension benefits: more than 50% of beneficiaries are resident in Ire/US and
ii. If earning income in pension fund: the earnings benefit pensions fund of which more than 50% of beneficiaries are resident in Ire/US

The comments made earlier regarding collective investment undertaking are of note in this instance also.

f. Additional comments on the LOB

Article 23(4) of the current treaty contains provisions to allow treaty benefits under the LOB for income arising from Shipping and Air Transport where certain ownership tests are met, as follows:

A resident of one of the Contracting States that derives from the other State income referred to in Article 8 (Shipping and Air Transport) and which is not entitled to the benefits of this Convention because of the foregoing paragraphs, shall nevertheless be entitled to the benefits of this Convention with respect to such income if at least 50 percent of the beneficial interest in such person (or in the case of a company, at least 50 percent of the aggregate vote and value of the company's shares) is owned directly or indirectly:

a. by qualified persons or citizens of the United States or individuals who are residents of a third state; or

b. by a company or combination of companies the principal class of shares in which are substantially and regularly traded on an established securities market in a third state,

provided that such third state grants an exemption under similar terms for profits referred to in Article 8 of this Convention to citizens and corporations of the other State either under its national law or in common agreement with that other State or under a convention between that third state and the other State.

The above Art23(4) is not contained in the 2016 Model.

The aviation leasing industry in Ireland is one of the major success stories within the Irish financial services industry. Fourteen of the top fifteen global lessors have operations in Ireland. The industry employees over 1,200 people in Ireland alone. To give an idea of the figures involved, $1.2tn worth of aircraft is expected to be financed in Ireland over the next 20 years during which time the industry is forecast to double in size.

An Irish leased aircraft takes off somewhere in the world every two seconds. It is clear that access for aircraft lessors to the US/Ireland treaty and meeting the criteria as outlined in the LOB is of considerable importance to what is a global industry.

A significant proportion of aircraft lessor ownership would not ultimately be held by "qualified persons" being Irish tax resident individuals or US citizens. Article 23 (4) in the current treaty is relied upon by several aircraft lessors and it would be important that the "third state" exemption language was included in the renegotiated treaty.

Consideration should be given to the inclusion of Article 23(4) of the current treaty in the renegotiated treaty as part of discussions.

Article 24 – Non- Discrimination

There is an addition to paragraph 4 of Art 24 under the 2016 Model which is not contained in the current treaty and notes "*Similarly, any debts of an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable capital of the first-mentioned resident, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned Contracting State.*" This content was also contained in the 2006 Model with the TE thereon noting that even though, for general purposes, the Convention covers only income taxes, the non-discrimination provisions apply to all taxes levied in both Contracting States, at all levels of government which is welcome.

Article 25 – Mutual Agreement Procedure

Paragraph 7, 8, 9 and 10 under Art 25 of the 2016 Model are new introductions. The Article contains rules requiring that certain disputes between tax authorities of the two treaty partners must be resolved through mandatory arbitration. The Model uses a 'last-best offer' approach to arbitration, which is substantively the same as the arbitration provision that is found in several other US income tax treaties. The 2016 Model includes detailed procedural rules governing how to resolve disputes between the two countries.

Article 26 – Exchange of Information and Administrative Assistance

Art 26(1) allows the competent authorities of the Contracting States to exchange information as is "foreseeably" relevant for purposes of carrying out the purposes of the treaty or domestic law of one of the Contracting States. The modification is consistent with the OECD recommendations for exchange of information provisions.

Additionally, Art 26(2) provides that the competent authority of the Contracting State receiving information under this Article may, with the written consent of the other Contracting State, make that information available to be used for other purposes allowed under the provisions of an existing mutual legal assistance treaty between the Contracting States that allows for the exchange of tax information.

Paragraph 5 provides that a Contracting State may not decline to provide information because that information is held by financial institutions, nominees or persons acting in an agency or fiduciary capacity. The technical explanation to the 2006 model notes that this 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.

Paragraph 7 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. Under paragraph 7, a Contracting State will endeavour to collect on behalf of the other State only those amounts necessary to ensure that any exemption or reduced rate of tax at source granted under the Convention by that other State is not enjoyed by persons not entitled to those benefits.

Paragraph 9 states that the competent authorities of the Contracting States may develop an agreement upon the mode of application of the Art.

Article 27 – Members of Diplomatic Missions and Consular Posts

There are no changes impacting the Current Treaty under this Article.

Article 28 – Subsequent Changes in Law

The 2016 Model includes this new Art which enables either the US or Ireland to cease granting treaty benefits in certain circumstances when changes to domestic tax law are enacted after the treaty has been signed.

Under Art 28(1), if changes in domestic tax law result in (i) the tax rate falling below the lesser of 15%, or, 60% of the general statutory rate for companies in [Ireland], or, (ii) the creation of a regime which exempts resident companies from taxation on substantially all foreign source income, including interest and royalties, then either Contracting State may consult to amend the treaty. In the event that the efforts to amend the treaty fail, a treaty partner may issue a diplomatic note stating that it will cease to apply the provisions of Arts 10 (Dividends), 11 (Interest), 12 (Royalties) and 21 (Other Income).

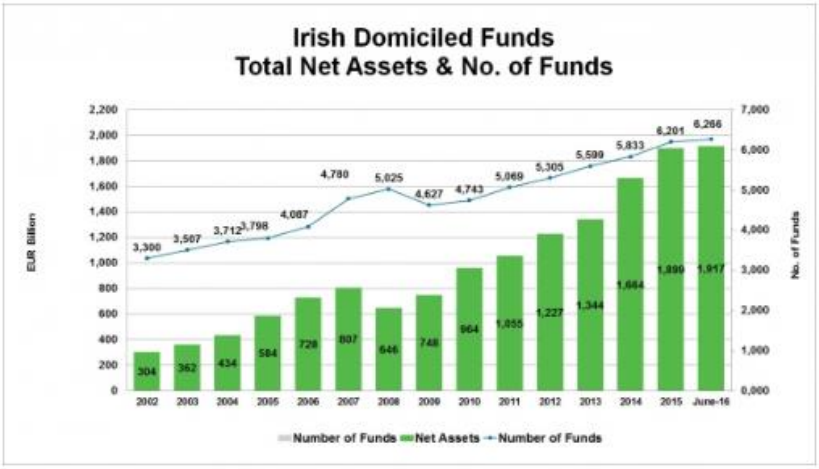
Treasury explains in the preamble to the 2016 Model that it believes such a fundamental change could call into question the original balance of negotiated benefits and the extent to which the treaty is needed to eliminate double taxation. US income tax treaties generally permit one of the partners to unilaterally terminate the treaty (the revised Model does not change this). The current treaty contains a provision for termination in Art 0, for example. However, Art28 would permit a partial termination of an income tax treaty, leaving in place not only the provisions under which business profits of an enterprise of one State may be exempt from tax in the other, but also the provisions in the treaty that require cooperation between the two countries, such as the information exchange provisions and the arbitration provision. This new provision is unusual in that it ultimately permits one of the treaty partners to unilaterally eliminate certain benefits of the treaty for both countries, without terminating the entire treaty.

Appendix I – WHT Rates for income received by EU Member State from the US

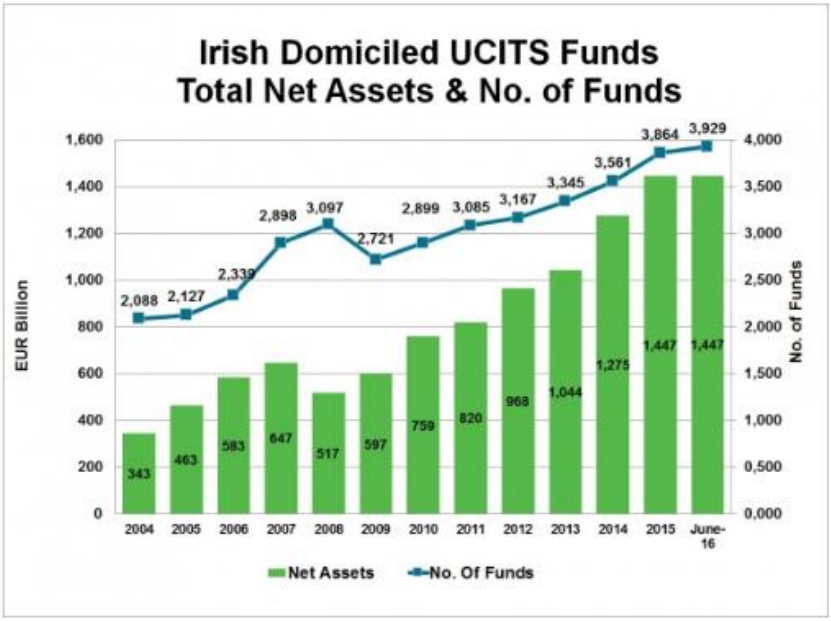
Country	Dividend Rate	Interest Rate	Royalties Rate
Austria	5	0	0/10
Belgium	0/5	0	0
Bulgaria	5	5	5
Cyprus	5	10	0
Czech Republic	5	0	0/10
Denmark	0/5	0	0
Estonia	5	10	5/10
Finland	0/5	0	0
France	0/5	0	0
Germany	0/5	0	0
Greece	-	0	0
Hungary	5	0	0
Ireland (current treaty)	5	0	0
Italy	5	10	0/5/8
Latvia	5	10	5/10
Lithuania	5	10	5/10
Luxembourg	5	0	0
Malta	5	10	10
Netherlands	0/5	0	0/15
Poland	5	0	10
Portugal	5	10	10
Romania	10	10	10/15
Slovak Republic	5	0	0/10
Slovenia	5	5	5
Spain	10	10	5/8/10
Sweden	0/5	0	0
United Kingdom	0/5	0	0

Appendix II – Fund activity in Ireland

Source: Central Bank of Ireland



Year End	Net Assets (€ Million)	Annual Asset Growth (%)	No. of Funds Including Sub Funds
2003	362,000	19	3,507
2004	434,477	20	3,712
2005	584,000	34	3,798
2006	728,000	25	4,087
2007	807,000	11	4,780
2008	646,000	-20	5,025
2009	748,000	16	4,627
2010	964,000	29	4,743
2011	1,055,000	9	5,069
2012	1,227,425	16	5,305
2013	1,344,340	10	5,599
2014	1,663,895	24	5,833
2015	1,898,823	14	6,201
June-16	1,916,900	1	6,266



Source: Central Bank of Ireland

Year End	Net Assets (€ Million)	Annual Asset Growth (%)	No. of Funds Including Sub Funds
2003	285,000	20	1,978
2004	343,377	20	2,088
2005	463,000	35	2,127
2006	582,737	26	2,339
2007	647,469	11	2,898
2008	517,000	-20	3,097
2009	597,331	16	2,721
2010	758,531	27	2,899
2011	820,051	8	3,085
2012	967,562	18	3,167
2013	1,043,666	8	3,345
2014	1,275,471	22	3,561
2015	1,446,872	13	3,864
June-16	1,447,345	0	3,929

Source: Central Bank of Ireland

Year End	Net Assets (€ Million)	Annual Asset Growth (%)	No. of Funds Including Sub Funds
2003	27,864	54	457
2004	43,548	56	541
2005	67,337	55	648
2006	92,669	38	826
2007	109,051	18	1,028
2008	93,999	-14	1,115
2009	113,094	20	1,174
2010	152,868	35	1,217
2011	181,797	19	1,420
2012	203,501	12	1,664
2013	235,255	16	1,849
2014	316,652	35	1,902
2015	369,068	17	1,961
June-16	385,026	4	1,965

Appendix III – Details of US Treaty requirements for PEs with EU member states

Country	A construction site is a PE if it lasts more than...
Austria	12 months
Belgium	12 months
Bulgaria	6 months
Cyprus	6 months
Czech Republic	12 months
Denmark	12 months
Estonia	6 months
Finland	12 months
France	12 months
Germany	12 months
Greece	**n/a**
Hungary	12 months
Italy	12 months
Ireland (Current)	12 months
Latvia	6 months
Lithuania	6 months
Luxembourg	12 months
Malta	12 months
Netherlands	12 months
Poland	12 months
Portugal	6 months
Romania	12 months
Slovak Republic	12 months
Slovenia	12 months
Spain	6 months
Sweden	12 months
UK	12 months

Deloitte.