Article 22 (Limitation on Benefits) 2016 U.S. Model Treaty—An Overview

Other Objective LOB tests

- Even if a resident is not a qualified person, the resident may nevertheless qualify for benefits on particular items of income if it meets one of the alternative provisions described in paragraph 3 (active trade or business), 4 (derivative benefits), 5 (headquarters company) , or as otherwise provided in paragraph 6 of Article 10 (Dividends), paragraph 3 of Article 11 (Interest) and paragraph 3 of Article 12 (Royalties)(cliff effect exceptions).

Discretion

- Even if a resident of a Contracting is neither a qualified person nor able to satisfy one of the other objective tests described in the prior

Publicly Traded Company Test

- Basic Rule: The principal class of the company's shares (and any disproportionate class of shares) is regularly traded on one or more recognized stock exchanges and the company satisfies at least one of the following additional requirements:
  - the company's principal class of shares is primarily traded on one or more recognized stock exchanges located in the Contracting State of which the company is a resident; or,
  - the company's primary place of management and control is in its State of residence.

Publicly Traded Company Test Continued

- Principal class of shares: the ordinary or common shares of the company representing the majority of the

Example 1: Publicly Traded Company

Subsidiary of Publicly Traded Company

- Basic Rules
- Ownership: At least 50% of the vote and value of the company's shares (and at least 50% of the vote and value of any disproportionate class of shares) in the company is owned (directly or indirectly) by 5 or fewer companies satisfying the publicly traded company test. If the publicly traded companies are indirect owners, each intermediate owner must be a resident of the other contracting state or a "qualifying intermediate owner" (QIO)
  - QIO means either an entity resident in a third state that has in effect a comprehensive income treaty with the source state addressing special tax regimes and notional deductions, or
  - A resident of the same Contracting State as the company seeking benefits.
- Base Erosion: Except with respect to benefits under Article 10 (Dividends) the company and (where applicable) its tested group must also satisfy a base erosion test.

Subsidiary of Publicly Traded Company

- Base Erosion Test has 2 requirements:
  - less than 50 percent of the tested subsidiary's "gross income" is paid or accrued, directly or indirectly, in the form of payments that are deductible by the tested subsidiary for tax purposes in the tested subsidiary's State of residence to ineligible persons, and
  - if there is a "tested group", then less than 50 percent of the tested group's gross income is paid or accrued, directly or indirectly, in the form of payments that are deductible by any member of the tested group for tax purposes in the tested subsidiary's State of residence, to ineligible persons.

Subsidiary of Publicly Traded Company

- There are 3 types of “ineligible persons”
  - persons that are not residents of either Contracting State entitled to benefits as individuals, governments, publicly traded companies, pensions, or tax-exempt entities;
  - persons that are residents of either Contracting State

Subsidiary of Publicly Traded Company (Connected Persons)

- Two persons are "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 is 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.

Subsidiary of Publicly Traded Company (Tested Group)

- Definition of “tested group”: The tested subsidiary and any company that either participates as a member with the tested resident in a tax consolidation regime, fiscal unity or similar regime that allows members of the group to share profits or losses, or any company that shares losses with the tested resident pursuant to a group relief or other loss sharing regime in the taxable year. If there is no tested group, then the base erosion test with respect to a tested group does not apply.

Subsidiary of Publicly Traded Company

Example 2: Subsidiary of a Publicly

Analysis Example 3 (Subsidiary of Publicly Traded Company)

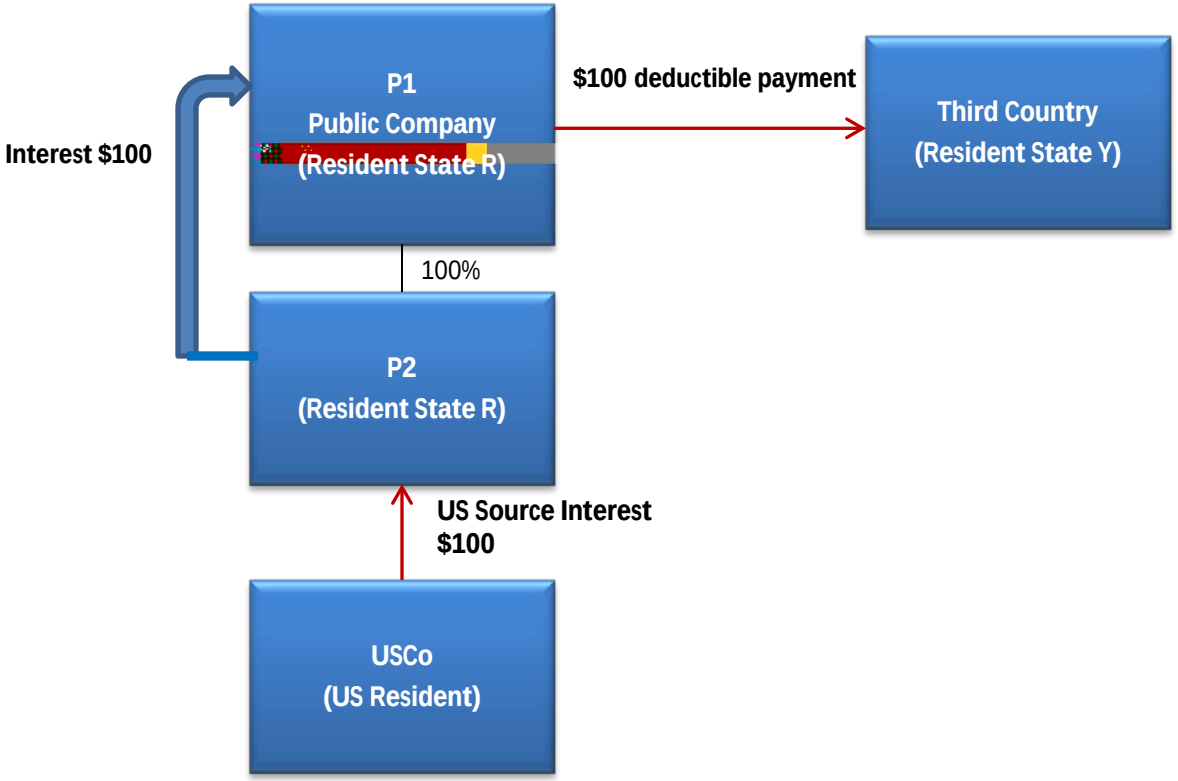
- Because the only benefit that R3 seeks is Article 10 Dividend cs 0 s-d(s)0.5 ( )10.8 (is)0.5 ( )]T

Analysis Example 4 (Subsidiary of Publicly Traded Company)

- Ownership prong is satisfied because R1 is a publicly

Example 5: Subsidiary of a Public Company – Indirect Base Erosion

Issue: Will P2 be a Qualified Person?



Ownership Test: Met. 100% own

Ownership/Base Erosion

- Basic Rule: The ownership base erosion test provides an additional method to become a qualified person for any form of legal person that is a resident of a Contracting State (a "tested person") if it satisfies both an ownership test and the base erosion test.

Ownership/Base Erosion Continued

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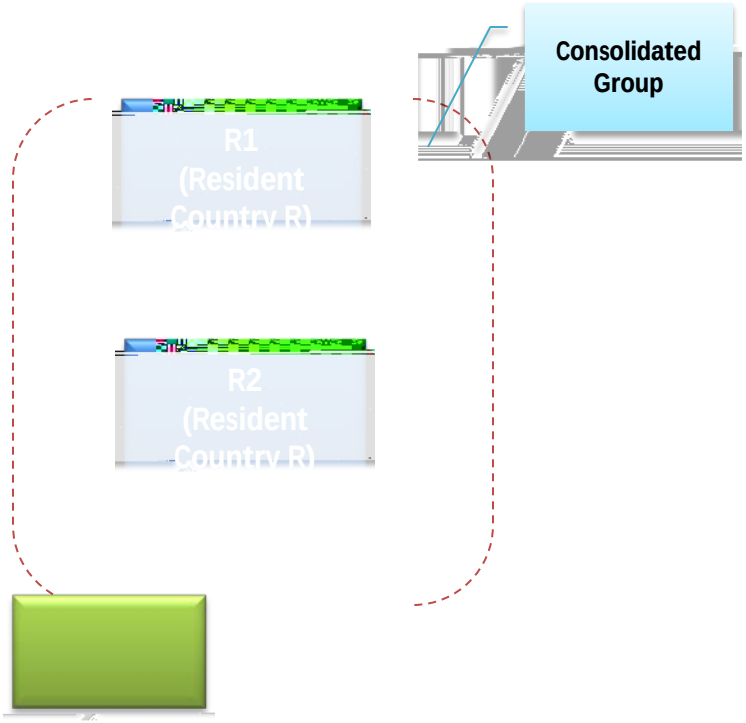
Example 6: Ownership/Base Erosion

Issue: Can R2 claim the benefits of Article 11 (Interest)?



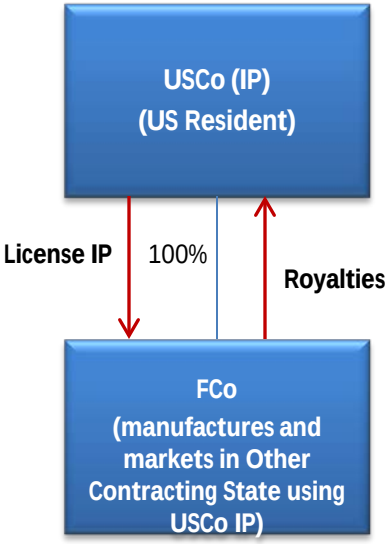
Example 7: Ownership/Base Erosion

Active Trade or Business

- A resident of a Contracting State engaged in the active conduct of a trade or business in that State may obtain treaty benefits with

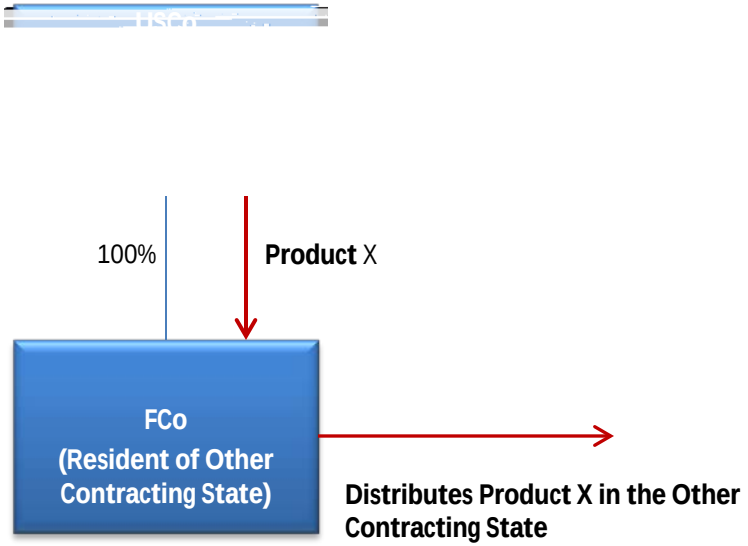
Example 9: Active Trade or Business

Issue: Will dividend qualify for treaty benefits under active trade or business test?



Analysis: Yes. Because activities conducted by FCo are factually connected to USCo's actively conducted US business royalties paid by FCo to USCo for use of IP will be treated as emanating from USCo trade or business.

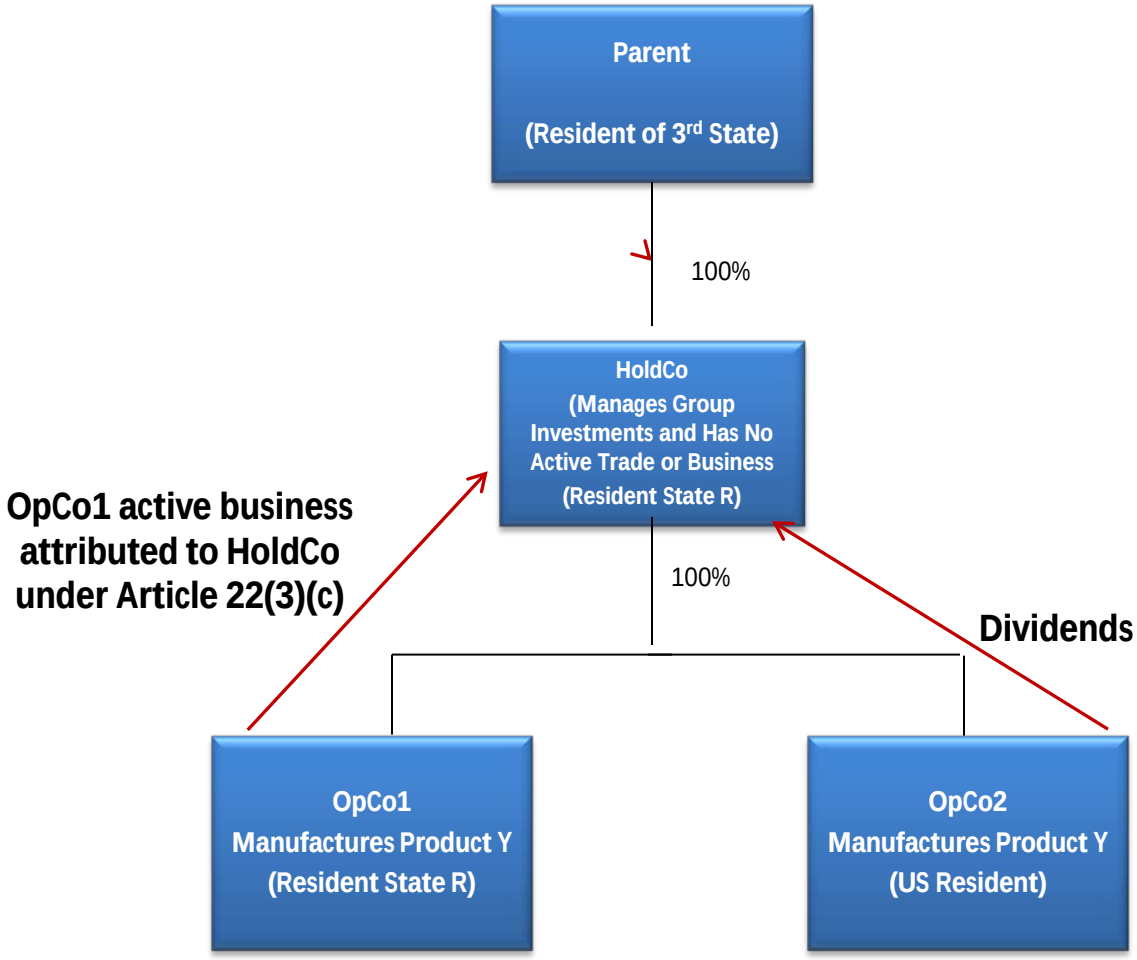
Example 10: Active Trade or Business (Emanates)



Because the distribution activity by FCo of Product X is factually connected to USCo's manufacturing of Product X, dividends paid by FCo to USCo will be treated as emanating from the USCo's trade or business.

Example 11: Active Trade or Business (Attribution of Activities)

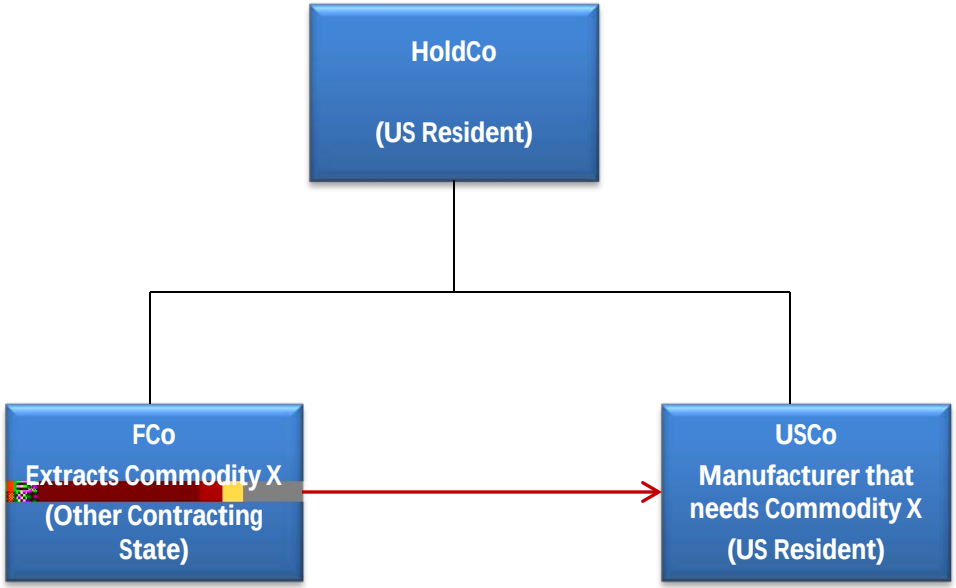
Issue: Will US source dividends be eligible for reduced withholding under the Active Trade or Business Test?



Analysis: No. The fact that HoldCo's deemed trade or business is the same as the trade or business of OpCo2 is not sufficient to demonstrate that dividends paid by OpCo2 are factually connected to HoldCo's actively conducted trade or business. Dividends will not enjoy reduced withholding rates under Article 10.

Example 12: Active Trade or Business (Attribution)

Issue: Will dividends from FCo to HoldCo be eligible for reduced withholding under the Active Trade or Business Test?



Analysis: Yes. HoldCo and USCo are Connected Persons. Thus HoldCo is considered engaged in an active trade or business from the attribution of USCO's activities. FCo's business activity provides upstream inputs (commodity X for use in HoldCo's deemed active trade or business), FCo's business is considered to form part of HoldCo's manufacturing business. Dividends paid by FCo to HoldCo will emanate from HoldCo's deemed active trade or business.

Derivative Benefits

- General Rule: A resident of a Contracting State that is not a qualified person may receive treaty benefits with respect to certain items of income if it meets the derivative benefits test. In general, a derivative benefits test entitles a company that is a resident of a Contracting State (a "tested company") to the benefits if:
  - 95 percent of the vote and value of its shares (and at least 50% of any disproportionate class of shares) are owned, directly or indirectly, by seven or fewer "equivalent beneficiaries" on at least half of the days of any twelve-month period that includes the date when benefits would otherwise be accorded, and
  - the tested company satisfies a 50% base erosion test.
- In the case of indirect ownership, each intermediate owner must be a QIO

Derivative Benefits

- There are 3 categories of equivalent beneficiaries (“EBs”) 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

Derivative Benefits (Equivalent Beneficiaries—Residents of 3rd State)

- Must satisfy LOB test for an individual, government, publicly traded company, pension or tax-exempt entity or with respect to dividends or interest received from a subsidiary in the resident's multinational corporate group a headquarters company, and
- must satisfy a rate equivalence test.

Example 14: Derivative Benefits (Rate Comparison Satisfied via

Derivative Benefits: Rule Allowing Individual to be Treated Like a Company for Purposes of Derivative Benefits Rate Comparison Test

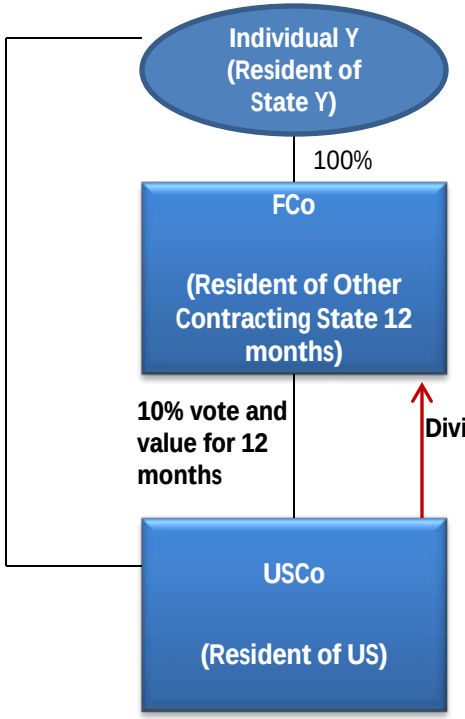
- Because dividends beneficially owned by individuals are generally not entitled to a rate of tax that is less than 15 percent of the dividend paid under U.S. tax conventions, whereas a company may be entitled to a rate of 5 percent or lower if certain conditions are met, absent this provision, individual shareholders of a tested company generally would not qualify as equivalent beneficiaries in the case of dividends because they would not pass rate comparison (15 percent is not less than or equal to 5 percent)
- Article 22(7)(e)(i)(B)(1)(I) of the 2016 Model provides a rule allowing individual to be treated like a company for purposes of derivative benefits rate comparison test

Derivative Benefits: Rule Allowing Individual ten3tultsvivia C1 (1)0.5 (o)m (en (ap

Example 15: Derivative Benefits (Rate Comparison)

Issue: Is FCo entitled to the 5% withholding rate on dividends under the FCo-USCo income tax treaty by virtue of the Derivative Benefits Test?

The terms of the US-Y income tax treaty with respect to Article 10(2) are identical to the 2016 US Model.

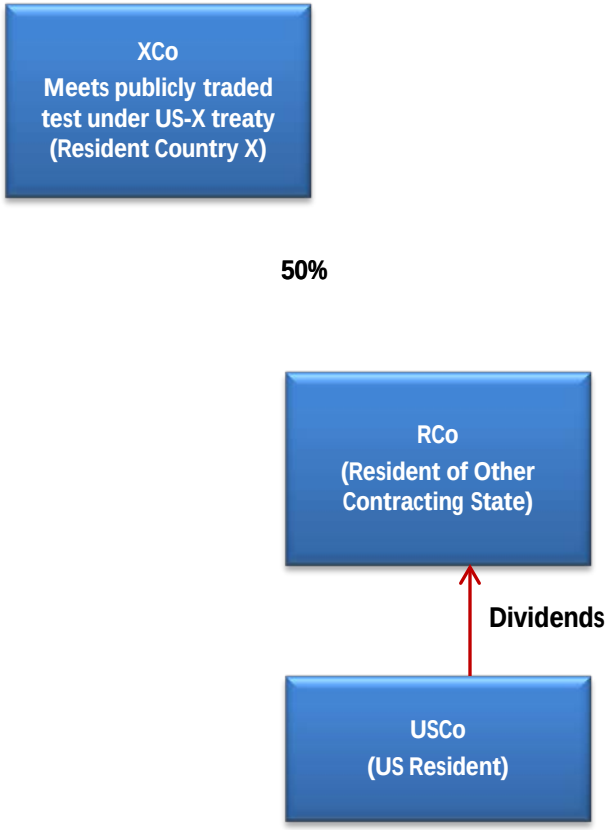


FCo is engaged in the active conduct of a trade or business in the Other Contracting State that is similar to the business of USCo in the US.

Analysis: Because (1) FCo is engaged in an active business similar to USCo's business and (2) Individual Y is treated as a publicly traded company for purposes of Rate Comparison, Individual Y will be treated as an Equivalent Beneficiary, assuming all other requirements (e.g., base erosion test and beneficial ownership) are satisfied. Therefore, FCo will be entitled to a 5% rate on dividends (rather than a 15% rate) paid by USCo.

Example 16: Derivative Benefits (Rate Comparison Not Met)

Issue: Are XCo and YCo equivalent beneficiaries under the derivative benefits test (which would entitle RCo to 5% withholding on dividends paid by USCo to RCo)?



Facts: The US has tax treaties with Country X and Country Y that provide terms similar to the 2016 US Model.
Analysis: XCo and YCo are not equivalent beneficiaries. Under the US-Country R treaty, RCo would be entitled to 5% withholding. However, for purposes of determining the dividend rate , XCo and YCo would be entitled to under their treaties with the US, they are considered to own 5% of USCo (50% x 10%) and thus would be entitled only to a 15% withholding rate, failing rate comparison.

Derivative Benefits: Business Profits, Capital Gains and Other Income

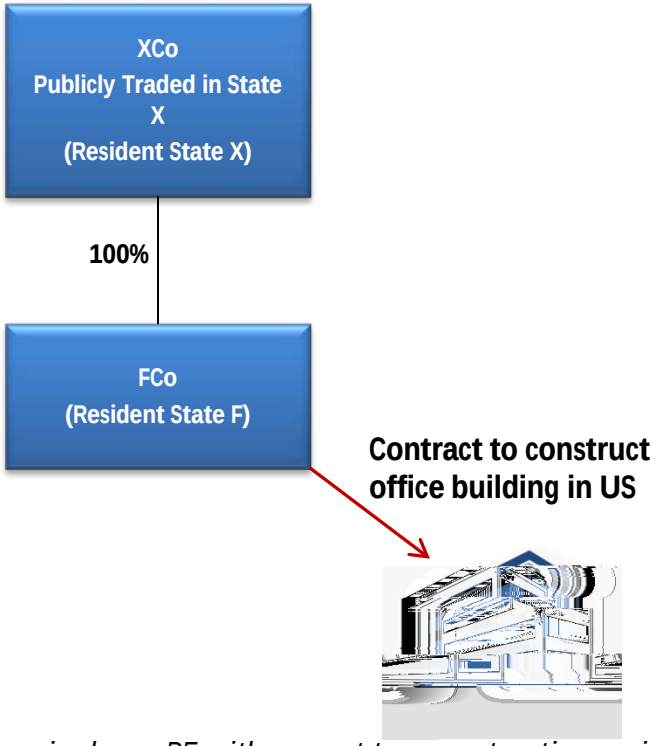
- The 2016 Model provides derivative benefits rules for items of income for which there are no fixed rates of tax to compare (business profits, capital gains, other income). The potential equivalent beneficiary must be entitled to a benefit under the tested convention that is at least as favorable as those that would apply under the baseline convention to such business profits, gains or other income.

Derivative Benefits: Business Profits, Capital Gains and Other Income

- Thus the benefits to be compared are:
  - The benefits that the source State would grant to the tested company if it qualified for benefits with respect to the item of income, profit or gain; and
  - The benefits that the source State would grant the potential equivalent beneficiary if it derived the income directly

Example 17: Derivative Benefits (Business Profits, Capital Gains and Other Income)

Issue: If the construction project extends beyond 183 days, will XCo be an equivalent benficiary with respect to business profits?



Facts: Under the US-F income tax treaty, an enterprise has a PE with respect to a construction project if it lasts more than 183 days. Under the terms of the US-X treaty, the PE standard for a construction project is 365 days.

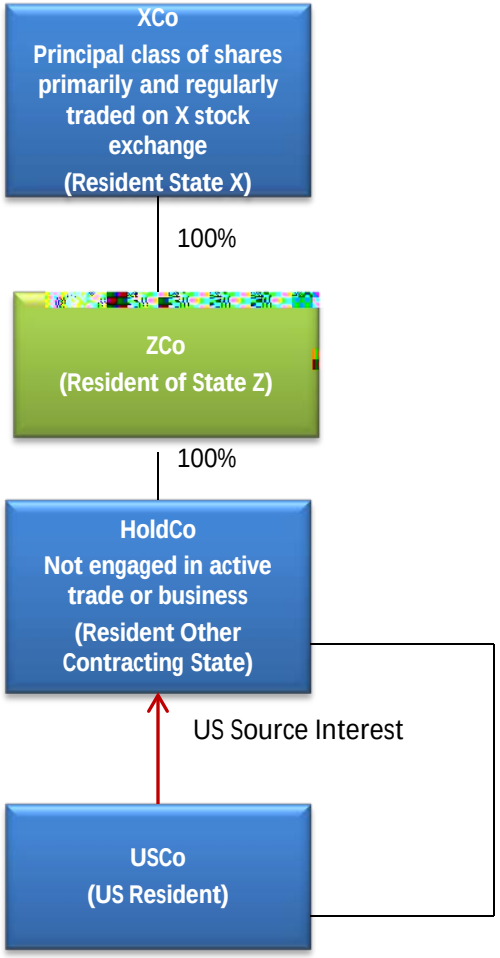
Analysis: No, because after 183 days, XCo would not be entitled to the same protection under the PE article of the US-X treaty that FCo would be entitled to under the US-F treaty (the 183 day standard of the US-F treaty is not as favorable as the 365 day standard of the US-X treaty).

Derivative Benefits Fiscally Transparent Entities

- An additional limitation on the definition of equivalent beneficiary applies where the item of income, profit or gain has been derived through a fiscally transparent entity under the laws of the Contracting State of the Company claiming the benefits
- In those cases, even though the resident may otherwise meet the requirements for equivalent beneficiary status, the resident will not meet the definition of equivalent beneficiary if the relevant item of income, profit or gain would not be treated as the income, profit or gain of that resident under a provision analogous to Article 1(6) of the U.S. Model Treaty had it, rather than the tested company, been paid the item of income for which the company is claiming benefits

Example 19: Derivative Benefits: QIO

Issue: Is X Co an equivalent beneficiary in which case interest payments from USCo to HoldCo would be exempt from withholding, assuming the base erosion test is met?



HoldCo derives and beneficially owns the US source interest. Under the US-Other Contracting State Convention, US source interest is exempt from tax. Similarly, State X has a treaty with the US providing for a comprehensive LOB provision and a zero rate of withholding on interest payments.

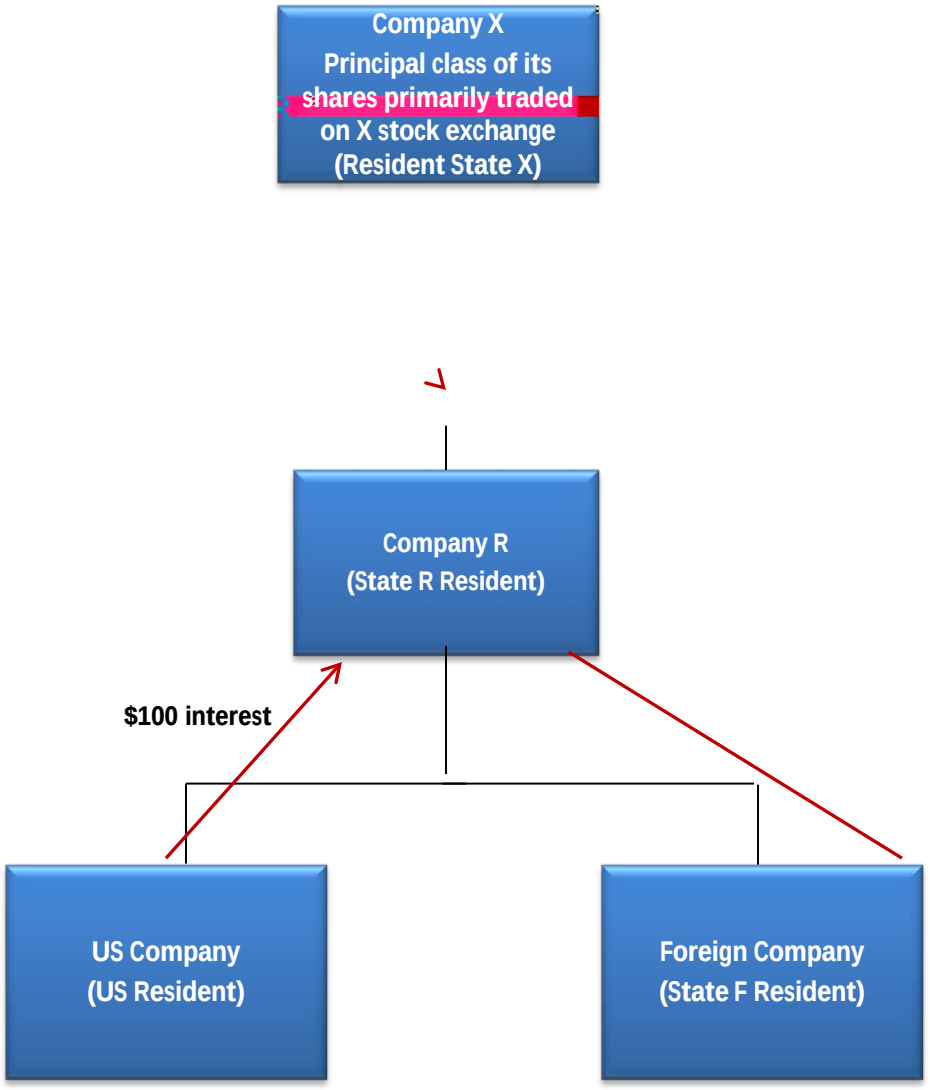
Facts same as Example 13 except ZCo is interposed between XCo and Holdco.

Analysis: State Z does not have in effect a comprehensive treaty with the US that includes provisions addressing STRs and notional interest deductions. Therefore, State Z is not a QIO. The requirements of derivative benefit are not satisfied.

Derivative Benefits—Base Erosion Test

- The Derivative Benefits test for base erosion is the same as the Base Erosion test for Ownership Base Erosion discussed above, except that the test treats payments as base eroding payments amounts paid or accrued to:
  - Persons who are not equivalent beneficiaries
  - Persons who are equivalent beneficiaries
    - Solely by reason of being a headquarters company,
    - That are connected persons with respect to the tested company and benefit from an STR in their state of residence tate y,

Example 20: Derivative Benefits (Base Erosion)



Cliff Effect

Amelioration of Cliff Effect

- The 2016 Model potentially ameliorates this “cliff effect” with respect to dividends, interest, and royalties where a company fails Derivative Benefits soley because it fails the rate comparison requirement of derivative benefits. Note this exception will not apply with respect to royalties where a benefit is claimed by a headquarters company under Article 22(5).
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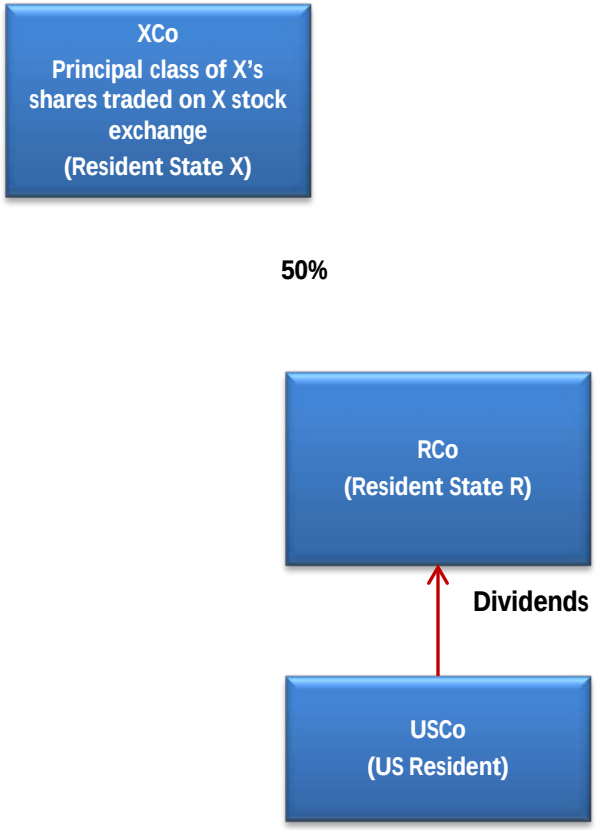
Example 20A: Cliff Effect Amelioration

Issues: Is RCo entitled to reduced withholding under the derivative benefits provision of the US-R Country treaty? If not, is RCo entitled to reduced withholding (and at what rate) under the Cliff Amelioration Effect rule of Article 10(6) of the 2016 US Model?



Analysis: RCo is not entitled to reduced withholding on derivative benefits as an equivalent beneficiary since only 50% of

Headquarters Company

- A resident of a Contracting State that does not qualify for benefits as a qualified person may be able to qualify for benefits with respect to dividends (5% withholding if 10% vote and value) and interest (10% withholding) paid by members of the company's multinational corporate group if it meets the headquarters company test
- Multinational corporate group ("MCG")means the company and its direct and indirect subsidiaries (and does not include upper-tier companies)

Headquarters Company: 6 Conditions

- Headquarters Company's primary place of management and control in Company's residence state
- MNG consists of companies resident in, and engaged in the active conduct of a trade or business in at least 4 countries and the trades or business carried on in each of the 4 states (or 4 groupings of states) generates at least 10% of MNG's gross income (the "4 State Gross Income Test")
- The trades or businesses of the MNG carried on in any one state other than the Contracting State of residence of such company generate less than 50% of the MNG's gross income

Headquarters Company: 6 Conditions Continued

- No more than 25% of the Headquarters Company's gross income is derived from the other Contracting State. Unlike the third condition described above, this condition only looks at the gross income earned by the company seeking status as a headquarters company, rather than the gross income of the MNG
- The Headquarters Company is subject the general corporate taxation rules for company's engaged in the active conduct 1BT/Hdi (t

Example 21: Headquarters Company

Analysis Example 21 Headquarters Company Year 1-- 4 State Gross Income Test Met

- Total gross income of MNG in Year 1 is $112 ($45+$25+$10+$10+$7+$10+$5)
- 10% of the MNG's gross income for Year 1 is $11.20 (112 x 10%)
- State X ($45) and State A ($25) meet this requirement for year 1
- Because State B and C have total gross income of $20 ($10+$10) from active trades or businesses carried on in their respective states and States D, E, and F have a total gross income of $22 ($7+$10+$5), from active trades or businesses carried on in their respective states these two groups of countries may be treated as the third and fourth members of the group

Analysis Example 21 Headquarters Company Year 2--4 State Gross Income Test Met

- Total gross income of MNG in Year 1 is $130 ($45+$25+$10+$10+$7+$10+$5)
- 10% of the MNG's gross income for Year 2 is $ 13 (130 x 10%)
- State X ($60) and State B ($20) meet this requirement for year 1
- Because States A and C have total gross income of $24 ($12+$12) from active trades or businesses carried on in their respective states

Analysis Example 21 Headquarters Company

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Discretionary Benefits

- If a resident cannot satisfy any of the objective tests, paragraph 6 allows the competent authority of the source State to grant benefits at its discretion, and after considering:
  - object and purpose of the Convention;
  - existence of a substantial non-tax nexus of resident to residence State; and
  - if establishment, acquisition, maintenance or conduct of resident's business has as one of its principal purposes the obtaining benefits of the Convention.
- Consultation with competent authority of residence State required (however such consultation is not a MAP).