UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

September 14, 2015

Robert Stack
Deputy Assistant Secretary (International Tax Affairs)
Office of the International Tax Counsel
US Department of Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Mr. Stack:

USCIB appreciates the opportunity to provide comments on the select draft provisions for the next US Model Income Tax Treaty (hereinafter "draft provisions"). We believe this process is especially important given that tax treaty negotiations are closed and therefore there is no opportunity to comment if a new provision appears for the first time in a signed treaty.

General Comments

USCIB is very concerned with the overall direction of the draft provisions. Tax treaties generally limit the ability of the treaty partners to impose tax on residents of the other country. Treaty partners accept limitations on their ability to tax because they wish to foster cross-border trade and investment. Over the past few decades we have seen the growth of limitation on benefits provisions. USCIB acknowledges that LOB provisions address legitimate concerns. Nevertheless, it is important to keep a balance – treaty benefits should not be granted inappropriately, but treaties must grant benefits to legitimate claimants or they will fail in their fundamental purpose – promoting cross-border trade and investment. USCIB believes that the draft provisions – on special regimes, subsequent changes in law, and limitation on benefits -- tilt too far in their attempt to prevent inappropriate claims of treaty benefits.

The draft provisions give a great deal of authority to the tax authorities implementing the tax treaties. Negotiated provisions can be negated by a determination made by a tax authority that, for example, a subsequent law change should result in the termination of benefits under the treaty. This would potentially significantly limit the ability of Congress to change US tax policy.

The draft provisions are not clear. This point will be addressed more completely in the specific comments section, but generally the provisions raise many questions concerning how they ought to be interpreted. Clarity is important to taxpayers, tax authorities, treaty negotiators, and legislatures, so if these provisions are to be adopted, they must be made much clearer.

USCIB believes that the proposals concerning special tax regimes and subsequent change in law reflect the Treasury's concern that once a treaty is in place, it is difficult to deal with changes in a treaty partner's law which change the balance of the treaty bargain and may result in what the Treasury views as the inappropriate granting of treaty benefits. Termination of a treaty is a drastic step and one that the Treasury and State Department may be loath to take. Partial termination, although permitted in certain circumstances under the Vienna Convention on the Law of Treaties, is also a difficult step. USCIB believes that it should be difficult to terminate an income tax treaty either completely or partially. Taxpayers enter into transactions many of which may involve long-term investments in reliance on the existence of stable agreements between treaty partners. These proposals would fundamentally undercut that stability. The proper remedy for addressing these issues is to renegotiate the existing balance of benefits and burdens.

It also seems that it will be very difficult to implement these new proposals. Treasury may view these provisions as a tool to bring a reluctant treaty partner back to the negotiating table, rather than as a power that would be frequently exercised. Treasury must, however, first get existing treaty partners to agree to the new proposals. As a practical matter, however, these rules may be unacceptable to a substantial number of existing US treaty partners, particularly those that have adopted special tax regimes or made subsequent changes to their tax laws that would put treaty benefits at risk. Therefore, adopting these provisions as part of the model will likely only make it more difficult to renegotiate treaties, rather than serving as a tool that will bring treaty partners back to the negotiating table.

Specific Comments

Special Tax Regimes

USCIB understands that from the Treasury Department's perspective, "the agreement by the source country to cede part or all of its taxation rights to the treaty partner is predicated on a mutual understanding that the treaty partner is asserting tax jurisdiction over the income. Stated simply, tax treaties contemplate that income relieved from taxation in the source country will be subject to tax in the treaty country." TD 8722, 62 Fed. Reg. 35673, 35674 (July 2, 1997). At the highest level of generality, then, it makes perfect sense *not* to afford treaty protection from source-country tax to certain types of taxpayers who go untaxed in the residence country, or are only taxed there on a remittance basis, or who benefit from a tax regime that has proven itself to be overly generous, in the judgment of the negotiators and the Senate.

In the past, US negotiators have done this by identifying the existing laws the exploitation of which will trigger a loss of treaty benefits.[1] The benefit of this approach is that it is clear to the

[1] [fn--The Treasury Department has often taken this route, for example, in Article XV of the (1962) Luxembourg treaty and Article 24(10) of the 1996 Luxembourg treaty, and Article 22(6) of the Barbados treaty, Article 1(7) of the 2001 United Kingdom treaty.

negotiators, Congress and taxpayers which regimes are problematic and each of them have had the ability to consider whether it should disqualify its user from obtaining treaty benefits.

The special tax regimes proposal lacks these characteristics. The proposal lacks sufficient clarity. Essentially, the proposal defines a special tax regime as nothing more than a regime that provides for preferential effective rates of taxation[2] and then provides for a series of exceptions, some of which are ill defined. The vagaries of the proposal leave not only taxpayers without sufficient guidance as to when it might apply, but also the very governments that negotiated the provision. Leaving something so consequential unclear in tax treaties may result in the unilateral denial of intended benefits. Obviously, treaties are not the place to codify a "we-know-it-when-we-see-it" test.[3]

The denial of benefits would also be unilateral in the sense that only benefits on interest, royalty or other income that is subject to the special regime would be denied treaty benefits. If the resident country considers the source country's denial of benefits inappropriate, the residence country would have little leverage since treaty benefits would continue to flow in the other direction.

The first exception – the application does not disproportionately benefit interest, royalties, or other income – should be part of the definition. Presumably, because of this exception, an overall reduction in the rate would not be a special tax regime.[4] A special tax regime does, however, include notional deductions with respect to equity; this seems inconsistent with the notion that an overall rate reduction is not a special tax regime. A notional deduction with respect to equity would relate to non-debt capital, would reduce the overall earnings of the company, and would therefore broadly reduce the tax on all income and not create a disproportionate benefit with respect to interest income. For example, a company with no interest income may be able to claim a notional deduction with respect to equity. Could such a deduction nevertheless be considered to create a disproportionate benefit with respect to interest income and, therefore, trigger the proposed provisions in the limitation on benefits article that reference special tax regimes? If a notional deduction with respect to equity is to be considered problematic, it would seem to be more appropriate to consider its impact under the draft provisions relating to subsequent law changes (because it could potentially have an impact on the general rate of company tax).

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[2] Clause (vii) provides an exception if the regime does not result in low or no effective rates of taxation. This exception requires agreement between the Contracting States and must be reflected in an exchange of diplomatic notes. So, if the Competent Authorities do not agree on how the regime would function and the resulting effective rate, a regime agreement might not be reached and a regime might be treated as a special regime despite significant doubts over whether a low or no effective rate of taxation results from the application of that regime.

[3] Cf. Stack Discusses the Progress and Future of BEPS, 147 Tax Notes 1593, 1594-1595 (June 29, 2015) (Do we really need a standard setter to say "Tax administrators will use the pornography test of "we know it when we see it" and "we'll get you when we want to"?").

[4] An overall rate reduction could potentially be covered by proposed new Article 28 concerning subsequent changes in law.

A country may decide to prefer a notional deduction with respect to equity instead of an overall rate reduction (which would clearly not be a special tax regime) in order to reduce the tax bias for debt over equity. Governments should prefer equity funding to debt funding since additional equity funding strengthens balance sheets and reduces the likelihood of companies failing (and in the case of big companies needing to be bailed out). The US Model already accentuates the tax debt bias by having higher withholding rates on dividends (generally 5% and 15%) and zero withholding on interest.

The proposal also denies tax benefits based on legislation, vaguely described, that has yet to be enacted. The proposal is clearly intended to reach patent box regimes, although there is an exception for a special regime "that, with regard to royalties, satisfies a substantial activity requirement".[5] Query whether the innovation box regimes currently being considered by the US Congress would meet this requirement? Would regimes benefitting from the OECD compromise which provides a grandfather until 2021 and a permanent 30% uplift meet this requirement? In deciding whether to adopt an innovation box and the details of any such regime, Congress may not wish to have its hands tied by the draft proposal.

Each tax regime that is arguably "special" for this purpose raises its own treaty policy questions, and the impact that each one should have on treaty benefits should be considered in advance by both the Executive and Congressional branches before it is decided that the regime warrants the denial of benefits. Thus, any special tax regime proposal should not attempt to cover in its scope future enacted legislation. Otherwise, the decision on whether a special tax regime is problematic will be largely left to the Internal Revenue Service (or each foreign tax authority) on exam.

Finally, one person's special tax regime is another person's appropriate tax policy. Today, there are many provisions in the US tax code that could be said to provide for preferential effective tax rates. Not even the Department of the Treasury believes that US companies availing themselves of these regimes should be denied treaty benefits. Yet, the proposal would put into question the ability of the United States to adopt such measures in the future without authorizing foreign governments to deny the regimes' users treaty benefits.

Subsequent Changes in Law

The draft provisions on subsequent changes in law look more broadly to income earned by companies resident in the other jurisdiction and are based on the notion that the same considerations that lead to the decision to enter into the tax treaty initially should allow for a partial termination of a treaty if the treaty jurisdiction substantially reduces its tax rate. That is, the US would not generally enter into a treaty with a country that does not impose a significant income tax. While a valid concern, USCIB believes that the application of this provision particularly in the context of corporate tax will be extremely difficult.

[5] Proposed new article 3 paragraph 1(l)(ii).

The technical explanation provides an example in which a Contracting State changes its law to allow companies to deduct an amount equal to a percentage of their equity up to 50% of what would otherwise be their taxable income. The example further states that most companies are able to use the maximum deduction. These facts result in a halving of the income tax rate, with the result that the subsequent change in law would permit the Other Contracting State to notify the first Contracting State that the Other Contracting State will cease to apply the provisions of Articles 10, 11, 12 and 21. This example raises a number of difficult issues. First, how is taxable income determined? The example implicitly applies foreign law for this purpose, but it is not clear that that is the correct standard. For example, assume income in Country A is 80 but income in Country A would be 50 if determined under US principles. Country A adopts a new deduction for a percentage of its equity that reduces income to 40 and applies a 20% rate to that taxable income. Country A income determined under US principles would still be 50. The effective rate cannot be determined based on taxable income as actually computed by Country A (8 of tax on 40 of income). So how should the effective rate be determined? Should the tax rate by considered to be 10% (8 of tax on 80 of income the tax base before the law change (does this mean that the foreign law at the time of treaty adoption becomes a kind of base line) or 16% (8 of tax on 50 of income determined under US principles)? It would seem that the theoretically correct answer would be to look at the US effective rate, since in the example the US is concerned about a reduction in tax below 15%. Should tax imposed under an applicable CFC regime be taken into account? How will the US determine whether substantially all of the income of resident companies is benefited? How will the provision apply to flow-through entities? Hybrids? How does the provision apply in countries where a large percentage of the total corporate tax is actually a state/provincial or cantonal tax and one of those localities provides a limited period of tax holiday?

USCIB is also concerned that once notice is given, it seems that the only way to restore benefits is through a renegotiation of the treaty. Would it be possible, for example, for a temporary tax holiday to result in the permanent termination of treaty benefits? Should there be a requirement of consultation concerning the application of the proposed article? It is highly likely that discussions would need to be held to determine the impact of the foreign law before official notice is provided to the treaty partner.

Unlike the proposed provision on Special Tax Regimes (which only applies to interest, royalties and other income), the proposal regarding Subsequent Changes in Law would deny the benefits of Article 10 (Dividends) in the event that the provision's conditions are triggered. Article 10 of the US Model currently provides for a 5 percent tax on dividends received by a treaty country company that owns directly at least 10 percent of the voting stock of the company paying dividends and a 15 percent tax on all other dividends. Article 10(3) of the US Model provides for an exemption from tax on dividends paid to a pension fund resident in the treaty partner. The effect of the proposed provision on Subsequent Changes in Law would be to remove those benefits and to subject all US dividends paid to residents of the treaty partner to the 30 percent US domestic withholding tax rate.

One of the conditions for triggering the proposed provision would be if the treaty partner provides an exemption from taxation to resident companies or individuals for substantially all foreign source income (including interest and royalties). We question the rationale for denying the benefits of Article 10 in that circumstance. This would treat tax reform in certain countries completely differently than existing treaties with countries having territorial regimes. USCIB does not understand the reason for this distinction. In addition, what would be the impact of the proposal on the US if the US were to adopt a territorial regime? Would our treaty partners be able to partially terminate any treaties containing this provision?

The vast majority of dividends paid to treaty country residents are likely to be either direct investment dividends paid by subsidiaries to parent corporations or portfolio dividends paid to individuals investing directly or through collective investment vehicles. In most cases, the treaty partner will not impose any tax on direct investment US dividends received by its domestic parent corporations, either because it exempts such dividends under a normal territorial regime or because it gives an indirect foreign tax credit which leaves no residual treaty country tax after taking into account the 35 percent US corporate tax already imposed on the distributed profits. Accordingly, the fact that the treaty country may change its domestic law subsequent to entering into the treaty to provide an exemption for substantially all foreign source income hardly seems to justify a denial of the benefits of Article 10 to direct investment dividends, since that subsequent law change is unlikely to have any effect on the already existing treaty country taxation of those dividends. If the United States had seen fit to grant the benefits of Article 10 to such direct investment dividends in the first place, it is difficult to see any policy rationale for denying those benefits due to a subsequent change in the treaty partner's domestic law that is unlikely to change the taxation of those dividends in the treaty country. Denying the benefits of Article 10 for such dividends would have a drastic effect on the climate for cross-border direct investment into the United States, undermining a key objective of the treaty.

In the case of portfolio dividends paid to individuals, it is worth considering by comparison US domestic law treatment of US individuals investing in US stock. Under section 1(h)(11) of the US Internal Revenue Code, a US individual will pay a maximum tax of 15 percent on a US dividend, unless he is in the top individual income tax bracket of 39.6 percent, in which case he will pay a maximum rate of 20 percent on the dividend. The reduced US domestic tax rates on such "qualified dividend income" are intended to mitigate the double (corporate and shareholder) taxation on corporate profits which could otherwise reduce economic efficiency and undermine long-term growth. It is anomalous that the United States has retained a 30 percent statutory withholding tax on dividends paid to foreign investors in US corporations (i.e., 10 to 15 percentage points higher than the maximum tax imposed by the United States on US investors). The withholding rate of 15 percent allowed under the US Model for dividends paid to individual residents of the treaty partner already captures for the United States most or all of the revenue that would be collected from a domestic individual investor. Under these circumstances, the taxation of the US dividend in the hands of the treaty country resident by the treaty country itself seems largely irrelevant, and it is very difficult to see why changes in the treaty country's law subsequent to the conclusion of the treaty should have any effect on the availability of the 15 percent rate for individual investors under Article 10. (This is true regardless of whether the subsequent change is to reduce the highest marginal individual rate below 15 percent or to introduce a "super" territorial regime.)

In short, we think the proposal to include Article 10 among the provisions whose benefits may be denied if there is a subsequent change in the treaty partner's domestic law is unwise and is likely to be disadvantageous to the United States by discouraging treaty country investment in US stocks for no material tax policy purpose.

<u>Limitation on Benefits</u>

The proposed changes to the limitations on benefits article offer a contrasting mix of provisions that recognize today's complex business structures and provisions that do not.

Treasury is to be commended for introducing a derivative benefits test to the model treaty unrestricted by geographic regions. This is a substantial step forward in recognizing that multinational enterprises routinely operate through subsidiaries located in a variety of jurisdictions, where there is no treaty shopping concern.

However, the balance of the proposed LOB changes would add new restrictions to every LOB test used by multinational enterprises to qualify for treaty benefits. These new restrictions do not adequately take into account the business realities of how multinational enterprises operate, and they would have the effect of restricting treaty benefits to a limited class of treaty residents. They would deny treaty access to many enterprises that do not violate the spirit of the LOB article; that is, residents of the treaty partner that are not treaty shopping. Each new requirement leads to additional complexity which creates burdens on cross-border trade and investment, so each new requirement should be amply justified. As discussed below, we do not believe many of the requirements proposed are so justified.

1. *Active trade or business*

A prime example of the failure to align the proposed LOB with common business structures appears in the proposed changes to the active trade or business test. The trade or business test is premised on the sound principle that if an enterprise has a solid business presence in the residence country, it, *prima facie,* is not treaty shopping as long as the income for which benefits are claimed is connected to that trade or business. Most every US treaty with a trade or business test recognizes that business enterprises may most efficiently be organized in a jurisdiction by separating certain functions, such as holding companies or finance companies, for valid business reasons and, therefore, allow the business attributes of operating affiliates to be attributed to a non-operating local affiliate for purposes of claiming treaty benefits with respect to (and only with respect to) income earned by the non-operating affiliate that is connected to the business conducted in the residence country. The proposal to limit attribution only to an affiliate that is itself an operating business would artificially allow treaty benefits if the qualifying income is received by the operating company, but deny treaty benefits if the same income is received by the non-operating affiliate.

We understand that Treasury considers the derivative benefits test to be the more appropriate test for holding companies. However, the active trade or business test is itself a limited LOB test in that it does not give blanket treaty access for all income, only income connected to the business operations. Many holding companies likely would not satisfy the derivative benefits test, particularly those that are privately held. Consider the following example:

> A Belgian company is privately held by a variety of US and European shareholders. The Belgian company is not publicly traded and is not at least 95 percent held by 7 or fewer persons. The Belgian company has significant manufacturing and sales operations in the United States through a consolidated group of US companies and has significant manufacturing and sales operations in Europe through several Belgian subsidiaries. Under the proposed changes to the active trade or business test, in order to qualify dividends paid by the US group for treaty benefits, the dividends would have to be paid to a Belgian operating company and up through the entire Belgian group before they could ever reach the shareholders. A much more direct, efficient, and sensible approach would be simply to pay dividends from the US group directly to the ultimate Belgian parent and then on to the shareholders, but the proposal would deny benefits in this case.

This example illustrates how the proposed restriction to the active trade or business test is not a supportable result. The parent company in this example has sufficient nexus with Belgium to address any concerns of treaty shopping (which is the purpose of the LOB test), yet the proposed restriction would result in the loss of treaty benefits. The only solution would be for the company to incur significant costs so that the dividends would be received by an operating subsidiary of the group (assuming there are no non-tax barriers to doing so). We do not believe that the significant business and accounting complexities and costs that would need to be incurred would be justified given the lack of treaty shopping concerns. Even adding the active trade or business test to the equivalent beneficiary definition (which would make considerable sense in light of the fact that an active trade or business is at least as justified to treaty benefits as a publicly traded company is, which is included in the equivalent beneficiary definition) would be insufficient here because the operating companies are owned by the holding company, not the other way around. Accordingly, we would recommend that the proposed restriction to the active trade or business test not be adopted.

2. *Base erosion*

The proposed changes to the base erosion tests of the Model provide another example of additional requirements that conflict with how business enterprises operate. Adding the base erosion test to the subsidiary of a publicly traded company further exacerbates this concern. First, the most recent base erosion tests are unduly restrictive because, although payments to local public companies that qualify for treaty benefits are excluded, the base erosion tests fail to exclude payments to subsidiaries of public companies that qualify for treaty benefits. This restriction is not supportable, as the parent company of publicly traded enterprises frequently is a mere holding company to which no payments are made; instead, payments (*e.g.*, interest, royalties on software licenses, etc.) are commonly made to operating subsidiaries within the larger corporate group. Accordingly, we suggest subsidiaries of public companies be added to the list of persons to which payments can be made and excluded from the base erosion test. Absent this change, treaty claimants operating exclusively within their country of residence often will fail the base erosion test.

Second, the proposed LOB would not exclude interest payments to third-party banks from the base erosion test. Business enterprises regularly borrow from banks and other third-party lenders in order to finance their operations and capital investments. Treating interest on these borrowings as bad base eroding payments unfairly penalizes taxpayers in capital-intensive industries where significant leverage is the norm. Interest payments to third-party banks should be excluded from the base erosion test in recognition that such payments do not present the type of conduit concerns addressed by tax treaty base erosion tests. To make this a meaningful adjustment to the test, it should not be restricted to banks that are publicly traded since publicly traded financial institutions typically operate through subsidiaries.

Third, adding a group-wide test in addition to the traditional single entity test further (and unnecessarily) adds complexity and restrictiveness for qualifying any subsidiary company for treaty benefits. We believe the typical wording of the base erosion test (which could be read to include a deductible payment by an affiliate sourced with the tested company that reduces the tested company's income under fiscal consolidation principles), combined with common law anti-abuse principles, is adequate to police any perceived abuse without adding further limitations on scope, complexities and administrative burdens.

Fourth, we question the policy rationale for the proposed exclusion from gross income of dividends that are "effectively exempted" from taxation. The role of the base erosion test is to determine whether a substantial part of the tested company's gross income has been diverted to "bad" recipients. The gross income can be exempt income or taxable income and the effect is the same. Further, we would stress that it is the rare case in which the dividend would be deductible by the payor. Hence, the dividend represents income that has been subject to tax, whether at the level of payor or the recipient. A policy that forces enterprises to operate in single entity form to avoid loss of treaty benefits promotes inefficiency and does not contribute to the goal of preventing treaty shopping.

3. *Intermediate ownership*

The proposed LOB would also add an intermediate ownership requirement to the derivative benefits test, much like the intermediate ownership requirements already embedded in the public company subsidiary and ownership-base erosion tests. Once again this proposed restriction does not take into account how multinational businesses operate and would be a major restraint on access to treaty benefits, where no treaty shopping concerns exist.

A typical multinational enterprise will have hundreds, if not thousands, of affiliates and ownership chains frequently include intermediate entities from a variety of countries that have nothing to do with accessing tax treaties or tax avoidance (*e.g.*, the result of acquisitions, regional holding structures, aligning business structures with reporting hierarchies or global business units, cash liquidity needs, etc.).

We do not believe that there is a credible justification for the intermediate ownership restriction in any of the tests applied to subsidiary companies. These restrictions do not address base erosion and conduit concerns, which are already addressed by base erosion treaty tests and domestic anti-conduit rules – rather, these restrictions merely serve to cause multinational companies to lose access to treaties.

Brother-sister affiliates are just as likely to receive deductible payments as intermediate owners. The only distinction between a sister affiliate and an intermediate owner is that intermediate owners can receive dividends which other affiliates cannot, but those dividends are not deductible so they do not present base erosion or conduit concerns. Intermediate ownership requirements do not address circumstances of inappropriate ownership because the ownership requirements of the public company subsidiary, ownership-base erosion, and derivative benefits tests (the tests that contain intermediate ownership requirements) must still be satisfied.

We do not believe that including these intermediary ownerships tests is justified merely because they are contained in other LOB ownership tests such as the subsidiary of a public company test. The current intermediate ownership tests do not address legitimate treaty shopping concerns. Rather than expanding their use to other LOB tests, they should be eliminated entirely. We understand that there may be a theoretical concern that a dividend to the intermediate owner may defer taxation in the hands of the parent company. This concern may exist in the exceptional case[6] in which the tax laws of the parent company taxes the dividend. However, we do not believe that such concerns justify the broad rules as proposed, because there is not a general treaty shopping concern.

Finally, while we welcome the addition of the derivative benefits test and the elimination of any regional restriction, the inclusion of the restriction on intermediate owners severely limits its

[6] In other words, in most cases the US should not be concerned about deferral on dividend distributions since the treaty partner would not impose additional tax in any event. The net effect of this rule in most cases would be to deny benefits to US parented entities at an ultimate cost to the US Treasury in the form of increased foreign tax credits.

utility, particularly with the additional limitation that an otherwise qualifying intermediate owner loses that status if the US treaty with its residence country does not have provisions addressing special tax regimes. The effect of this further limitation is that, when this test first appears in a treaty, no intermediate owner will meet the test and it will be a significant period of time, if ever, before there is a body of treaties that will allow intermediate owners to meet the test, assuming future policy makers perpetuate this approach.

4. *Discretionary grant of treaty benefits*

The ability of taxpayers to request the competent authority to grant treaty benefits where none of the objective tests have been met is a vital component of the LOB article. It is a recognition that a treaty resident may fail the objective tests and still not be treaty shopping. It has been appropriately described by the Joint Committee on Taxation of the US Congress as a "safety net." If the proposed changes to the LOB article are adopted, it will become increasingly important as more and more companies will fail to qualify under the objective tests.

Under current treaty policy, the taxpayer must establish to the satisfaction of the competent authority that the establishment, acquisition or maintenance of such person or the conduct of its operations did not have as one of its principal purposes the obtaining of benefits under this Convention. This has been the policy since the LOB article was first introduced in its current form. The Treasury Technical Explanation typically makes clear that the competent authority has broad discretion in determining whether benefits will be granted, including the ability to limit the grant to specific income items. Notwithstanding the clearly stated standard and the broad discretion exercised by the competent authority, it is proposed that a further hurdle be added for taxpayers that need this safety net beyond establishing they are not treaty shopping under the historic standard. Namely, the taxpayer would also have to establish a "substantial nontax nexus" to its residence state. We see no justification for this additional and vague standard. Apparently, it would preclude a taxpayer that has established that it is not treaty shopping from choosing a jurisdiction because local tax benefits are provided. Would a nontax nexus be satisfied where a US party joint ventures with a non-US capital provider and the capital provider insists on using a jurisdiction because he has other ventures organized in the jurisdiction and is comfortable with the local professional service providers?

The US competent authority is extremely thorough in considering requests under the standards that were in place before the recent issuance of Rev. Proc. 2015-40; the process is lengthy and demanding. Adding more complexity and uncertainty by adding this new standard at a time when an increasing number of companies will have to rely on discretionary grants is unnecessary and unwise. In that regard, we note our strong concern that Rev. Proc. 2015-40 replaces the treaty-dictated standard with standards now being proposed for future treaties after public input. This is incorporating into existing treaties policies only now being proposed for future treaties in violation of the policy clearly enunciated in existing treaties[7]. We urge the Treasury to take the lead in reversing this highly inappropriate measure.

Overall, we believe that Treasury should curtail potential abuses of the LOB article but the solution for any perceived abuse should be formulated and tailored to address the particular abuse and not penalize treaty residents that are not treaty shopping. The multiple additional restrictions in the proposed LOB article are not sufficiently constrained and would severely restrict access to treaty benefits for many business enterprises that are entitled to those benefits, significantly undermining the fundamental purpose of treaties to facilitate cross-border trade and investment.

New proposals relating to expatriated entities

Treasury has proposed paragraphs under Articles 10, 11, 12 and 21 (dividends, interest, royalties and other income) relating to denial of treaty benefits with respect to payments made by an expatriated entity for a period of ten years after the acquisition of the domestic entity is concluded. USCIB believes that these provisions should not apply to payments to unrelated persons. The unrelated person would not have benefitted from the expatriation and their entitlement to treaty benefits should not depend on the behavior of another person.

Sincerely,

William J. Sample
Chair, Taxation Committee
United States Council for International Business (USCIB)

cc:
Danielle E. Rolfes, International Tax Counsel, Office of Tax Policy, US Treasury
Henry Louie, Deputy International Tax Counsel (Treaty Affairs), Office of Tax Policy, US Treasury

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[7] As Deputy Assistant Secretary Stack recently noted at the OECD Tax Conference in June, if countries do not like the results under current treaties, the appropriate response is to negotiate a new treaty, not to unilaterally adopt rules that violate the existing agreement.

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