Irish Tax Institute

Response to the Department of Finance and Revenue Commissioners Joint Consultation on the Double Tax Treaty with the US

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About the Institute

The Irish Tax Institute is the leading representative and educational body for Ireland's AITI Chartered Tax Advisers (CTA) and is the only professional body exclusively dedicated to tax. Our members provide tax expertise to thousands of businesses and individuals in Ireland and internationally. In addition, many hold senior roles within professional service firms, global companies, Government, Revenue and state bodies.

The Institute is the leading provider of tax qualifications in Ireland, educating the finest minds in tax and business for over thirty years. Our AITI Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice. A respected body on tax policy and administration, the Institute engages at the most senior levels across Government, business and state organisations. Representing the views and expertise of its members, it plays an important role in the fiscal and tax administrative discussions and decisions in Ireland and in the EU.

Executive Summary

The Irish Tax Institute ("the Institute") welcomes the publication of this consultation ahead of the proposed treaty negotiations with the US. It is expected that the new Model US Treaty (the "Model Treaty") will form the primary basis for the negotiation of a new treaty and our submission outlines the challenges that the Model Treaty would present from an Irish perspective.

We have consulted with diverse sectors of our membership in preparing this submission, seeking views from practitioners, large corporates and private businesses. The feedback from members is that the Model Treaty, in particular the Limitation on Benefits article ("LOB"), would have widespread impact for all company types. The taxpayers that would be most impacted are:

- Irish Plcs which have their primary listing on overseas stock exchanges, together with their Irish and US subsidiaries.
- The subsidiaries of Irish Plcs which source the majority of their finance outside Ireland.
- The Irish and US subsidiaries of US multinationals in cases where they are indirectly held.
- Private companies in cases where the majority of shareholders are non-Irish resident.
- Listed funds which are traded on overseas stock exchanges.
- Private funds and securitisation companies in cases where the majority of shareholders are non-Irish resident.

This list spans the entire range of Irish and US businesses operating in Ireland supporting employees, not only in their own groups, but in all the smaller Irish businesses supplying them etc.

The requirement to have you primary listing on your local stock exchange, management and control tests that cannot be met by companies with a large global footprint, new base erosion tests which penalise companies sourcing funds from outside their local economy and tests around active trade or business that are unclear, when taken together render this new model unworkable for thousands of businesses in Ireland. Refer to our table on pages 9-12 for a summary of the LOB provisions impacting each of these taxpayers.

Our submission also addresses a number of other important issues which need to be taken into account during the treaty negotiations.

Irish Tax Institute

Section 1:

Summary of Recommendations

Summary of Recommendations

Timing

The Model Treaty represents a fundamental change to the existing Ireland – US Treaty. It is creating much uncertainty for businesses from an Irish perspective and comes amidst the introduction of a new global tax framework to which companies must now adapt. Before detailed treaty negotiations commence, it is imperative that companies have sufficient time to reflect on the treaty provisions and assess the practical impact.

The US Model Treaty is a treaty designed for a large economy

The new Model Treaty has been designed with the US economy in mind and it will form the basis for US treaty negotiations with all countries, large and small. The LOB represents a real challenge for Ireland and, as currently drafted, Irish businesses and funds of all sizes would find it difficult to satisfy most of these tests. Ireland's unique position as a small open economy, one which has a small domestic capital pool, a significant international capital pool and is reliant on significant foreign direct investment, should be acknowledged upfront as part of treaty discussions.

EU law implications

There are concerns that the LOB may contravene the principles of the Fundamental Freedoms protected by the European Treaties, and recent proceedings taken by the European Commission indicate that it shares these concerns. Before any new treaty is agreed, it is important that the Government carefully considers the potential EU law ramifications.

Limitation of Benefits

In essence, the LOB in the Model Treaty is designed to prevent access to tax treaties where an entity is owned or financed from abroad and where its shares are traded on an overseas stock exchange. The tests in the LOB have been designed in the context of larger economies and they would not necessarily represent significant barriers in US treaty negotiations with other large economies. However, the LOB imposes an unduly narrow ownership and base erosion test for smaller economies, like Ireland, which have less developed capital markets. Irish businesses will struggle to meet prescribed LOB tests which have been designed from the US, large economy, perspective.

We recommend the following changes be considered in relation to the Limitation on Benefits Article;

- **Publicly Traded Company Test – Local stock exchange:** The stock exchange element of the Publicly Traded Company Test could be widened to include companies and funds where the principal class of their shares is substantially and regularly traded on one or more recognised stock exchanges (specifically including stock exchanges in the EU, European Free Trade Area and the US. Post Brexit, it will also be important to ensure that any definition of a recognised stock exchange includes UK exchanges).

- **Publicly Traded Company Test - Primary place of management and control:** As part of negotiations on this clause, it would be helpful to agree upfront that operational day-to-day decision making can be devolved to local subsidiaries if the substantive financial and policy decisions for the group are exercised in Ireland (or the US in the case of a US Plc).

- **Ownership Test:** Under the existing Ireland – US treaty, the Ownership Test can generally be satisfied if the shares are owned by either Irish or US residents. We believe that the Ownership Test in the new treaty should also allow for either Irish or US ownership, as is the case in the current Ireland – US Treaty) This would ensure that Irish companies which have received investment from US investors could still satisfy this test.

- **Derivative Benefits Test:** We believe that there should be no limit on the number of equivalent beneficiaries to satisfy this test once, for example, all shareholders are equivalent beneficiaries.

- **Indirect Ownership:** The definition of Qualifying Intermediate Owner ("QIO") could be widened to include residents in a country which has a comprehensive treaty with the US or Ireland. If agreement cannot be reached with the US on the exclusion of the 'new treaty' requirement, one possible and more reasonable solution would be to defer the QIO provision until a pre-determined number of territories have signed new treaties with the US.

- **Active Trade or Business Test:** As part of negotiations, it would be helpful if upfront clarity could be provided by the US on the practical application of this test so that the full impact on Irish companies can be assessed. Examples of companies who pass this test would also be welcome.

- **Headquarters Company Test:** Currently, it is difficult to envisage many Irish companies gaining access to the treaty by virtue of this test. As part of treaty negotiations, it would be useful to revisit the relevant thresholds to ensure that this test could have reasonable application for Irish companies.

- **Base Erosion Test:** To alleviate the potential EU law implications (referred to above), it would be advisable that payments made to EU residents are not taken into account for the purposes of the base erosion test. If agreement on this point cannot be reached, perhaps a compromise might be that payments made to EU residents who benefit from a Special Tax Regime ("STR") could remain subject to the base erosion test.

  At a minimum, we believe that the carve out for interest payments made to certain banks under the current Ireland – US Treaty (Article 23(2)(c)(ii)) should be retained. While this clause has worked well in the existing treaty, it is important to recognise that companies no longer rely solely on banks for debt financing and it is becoming more common to borrow from institutional investors. As such, a widening of this carve out could also be considered.

Special Tax Regimes (STRs)

With the exception of Tonnage Tax (discussed below), it is our understanding that Ireland does not currently operate any preferential regimes which would fall within the Model Treaty definition of an STR. It is important that there is upfront agreement with the US on this issue. Similarly, the Irish negotiating team should seek clarity on the STRs in operation in the US.

As mentioned, Ireland's Tonnage Tax regime has been identified as a possible STR. We also understand that a similar regime operates in the US. As part of negotiations, it might be helpful to seek equivalent treaty treatment for all Irish and US companies availing of the regimes in both countries.

Dividend Withholding Tax

Article 10 of the Model Treaty and the existing Ireland-US Tax Treaty both provide for a reduced rate of Dividend Withholding Tax of 5%. The US has negotiated bi-lateral treaties (e.g. with the UK) which provide

for a zero rate withholding tax on dividends where certain conditions are met and this might be something that is considered in the context of the new Ireland-US Treaty.

US Section 385 regulations

The new US Section 385 regulations seek to deny a deduction for certain related party interest. However, the interest income would be taxable in Ireland, resulting in a mismatch between the Irish and US treatment. While this is not an issue specific to the Model Treaty, we believe that it should also be considered as part of the treaty negotiations.

Irish Tax Institute

Section 2:

Summary of taxpayers most impacted by the Model Treaty

Company Type	Existing test(s) relied on under current Treaty	Why the taxpayer would find it difficult to pass this test under the Model Treaty	Changes to the Model Treaty that would resolve this problem
Irish Plc Groups with a primary listing on non-Irish stock exchange	Publicly Traded Company Test (for the parent company) AND Subsidiary of Publicly Traded Company Test (for subsidiaries)	For both tests, the listed company must now have its primary listing on the Irish stock exchange. There are some concerns that this listing requirement would not be compatible with the EU principles of Fundamental Freedoms and therefore could be in breach of EU law.	The Publicly Traded Company Test could be extended to include any recognised stock exchange (specifically including stock exchanges in the EU, European Free Trade Area and the US. Post Brexit, it will also be important to ensure that any definition of a recognised stock exchange includes UK exchanges).
Irish and US subsidiaries of Irish Plcs with a primary listing on the Irish Stock Exchange	Subsidiary of Publicly Traded Company Test	The subsidiary must now also satisfy a base erosion test. There are some concerns that the base erosion test would not be compatible with the EU principles of Fundamental Freedoms and therefore could be in breach of EU law. ============ In addition, indirectly held subsidiaries must now be held by a qualifying intermediary owner ("QIO"). There are some concerns that this provision would not be compatible with the EU principles of Fundamental Freedoms and therefore could be in breach of EU law. ============ Typically, the Active Trade or Business Test has been the alternative test for subsidiaries of Plcs that don't satisfy the Subsidiary	To alleviate the potential EU law implications, it would be advisable that payments made to EU residents are not taken into account for the purposes of the base erosion test. At a minimum, we believe that the carve out for interest payments made to certain banks under the current Ireland – US Treaty (Article 23(2)(c)(ii)) should be retained. ============ The definition of QIO could be widened to include residents in a country which has a comprehensive treaty with the US or Ireland. If agreement cannot be reached with the US on the exclusion of the 'new treaty' requirement, one possible and more reasonable solution would be to defer the QIO provision until a pre-determined number of territories have signed new treaties with the US. ============ In the preamble to the Model Treaty, the US Department of Treasury note that a "technical explanation of the 2016 Model" would be released in Spring in which guidance would be provided on the meaning of these terms. No technical explanation has been released to date. As part of negotiations, it would be helpful if

Company Type	Existing test(s) relied on under current Treaty	Why the taxpayer would find it difficult to pass this test under the Model Treaty	Changes to the Model Treaty that would resolve this problem
…..Cont'd **Irish and US subsidiaries of Irish Plcs with a primary listing on the Irish Stock Exchange**	…..Cont'd Subsidiary of Publicly Traded Company Test	…..Cont'd of a Publicly Traded Company Test. Given the tightening of other tests in the LOB article, this test will become more important for companies going forward. The precise meaning and application of the terms in this test are unclear and there are real concerns that actively trading companies will not be able to satisfy this test.	…..Cont'd upfront clarity is provided by the US on the practical application of this test so that the full impact on Irish companies can be assessed.
US and Irish subsidiaries of US Plcs (with a primary listing on a US stock exchange)	Subsidiary of Publicly Traded Company Test	As mentioned above, indirectly held subsidiaries must now be held by a QIO. There are some concerns that this ownership requirement would not be compatible with the EU principles of Fundamental Freedoms and therefore could be in breach of EU law. ============ Even where the subsidiary is held directly, it must now also satisfy a base erosion test. There are some concerns that this base erosion test would not be compatible with the EU principles of Fundamental Freedoms and therefore could be in breach of EU law.	The definition of QIO could be widened to include residents in a country which has a comprehensive treaty with the US or Ireland. If agreement cannot be reached with the US on the exclusion of the 'new treaty' requirement, one possible and more reasonable solution would be to defer the QIO provision until a pre-determined number of territories have signed new treaties with the US. ============ As above, to alleviate the potential EU law implications, it would be advisable that payments made to EU residents are not taken into account for the purposes of the base erosion test. As referred to above, we believe that the carve out for interest payments made to certain banks under the current Ireland – US Treaty (Article 23(2)(c)(ii)) should be retained.

Company Type	Existing test(s) relied on under current Treaty	Why the taxpayer would find it difficult to pass this test under the Model Treaty	Changes to the Model Treaty that would resolve this problem
Private Companies	Ownership Test	More than 50% of the shares must now be held by Irish residents. There are some concerns that this ownership requirement would not be compatible with the EU principles of Fundamental Freedoms and therefore could be in breach of EU law. ============ While the existing Treaty contains a base erosion test, there are concerns that this provision would not be compatible with the EU principles of Fundamental Freedoms and therefore could be in breach of EU law. ============ As discussed above, the Active Trade or Business test has been the alternative test for private companies that don't satisfy the Ownership Test. Given the tightening of other tests in the LOB article, this test will become more important for these companies going forward. The precise meaning and application of the terms in this test are unclear and there are real concerns that actively trading companies will not be able to satisfy this test.	The wording of the existing treaty should be retained to allow 50% of the owners to be either Irish or US resident. ============ In the preamble to the Model Treaty, the US Department of Treasury note that a "technical explanation of the 2016 Model" would be released in Spring in which guidance would be provided on the meaning of these terms. No technical explanation has been released to date. As part of negotiations, it would be helpful if upfront clarity is provided by the US on the practical application of this test so that the full impact on Irish companies can be assessed.

Company Type	Existing test(s) relied on under current Treaty	Why the taxpayer would find it difficult to pass this test under the Model Treaty	Changes to the Model Treaty that would resolve this problem
Funds	Publicly Traded Company Test Or Ownership Test	The fund must now have its primary listing on the Irish stock exchange. There are some concerns that this listing requirement would not be compatible with the EU principles of Fundamental Freedoms and therefore could be in breach of EU law. ============= More than 50% of the shares must be held by Irish residents. In addition, indirectly held funds must be held by a QIO.	The Publicly Traded Company Test should be extended to include any recognised stock exchange. ============= The wording of the existing treaty could be retained to allow 50% of the owners to be either Irish or US resident.

Irish Tax Institute

Section 3:

Issues to be considered in the context of the treaty negotiations

Introduction

Given the level of US foreign direct investment in Ireland and the importance of the US market to Irish indigenous companies, the US treaty is arguably one of the most significant of Ireland's 72 Double Tax Treaties. It is expected that the Model Treaty, published earlier this year, will form the primary basis for the renegotiation of Ireland's Double Tax Treaty with the US.

The Institute welcomes the publication of this consultation ahead of the proposed treaty negotiations. This consultation provides an opportunity for interested parties such as the Institute to express their views on the key elements of the Model Treaty and the challenges that these would present from an Irish perspective.

The challenges referred to primarily relate to the LOB. The LOB has been designed in the context of large economies and, as currently drafted, Irish businesses and funds of all sizes would find it difficult satisfy any of the LOB tests. We outline the specific issues with the LOB later in this submission, together with a number of other points which should be considered as part of the treaty negotiations.

Backdrop to negotiation

Given Ireland's unique economic relationship with the US and the need for bi-lateral engagement in maintaining these relations, we recognise the importance of renegotiating the Ireland – US Treaty. However, it is worth considering the backdrop against which negotiations will take place.

Importance of timing

The Model Treaty represents a fundamental change to the existing Ireland – US Treaty. It is creating much uncertainty for businesses from an Irish perspective and comes amidst the introduction of a new global tax framework which companies must now adapt to.

Before detailed treaty negotiations commence, it is imperative that companies have sufficient time to reflect on the treaty and assess its practical impact.

Explanatory note on Model Treaty

In the preamble to the Model Treaty, the US Treasury notes that a "technical explanation of the 2016 Model" would be released in Spring in which clarity would be provided on the application of the new provisions included therein. No technical explanation has been released to date.

The Model Treaty contains a number of subjective provisions and this has created uncertainty as regards its intended application. The Treaty has been written from a US perspective and some of the key terms therein have originated from US domestic legislation. It is important to consider whether it is appropriate to apply these terms to an international tax treaty and whether they are 'fit for purpose' in this context.

It is important that the US Treasury release an explanatory note in advance of any negotiations so that businesses can assess the potential impact of the key treaty provisions. In particular, we would welcome practical examples of taxpayers who would satisfy;

- The Active Trade or Business Test

- The Primary Place of Management and Control Test

BEPS - Multilateral Instrument

Following two years of negotiations, a number of important treaty changes have been agreed between OECD member states as part of the BEPS project. These changes will have widespread implications for companies.

Member states are currently finalising a multi-lateral instrument ("MLI") which will incorporate these changes into bi-lateral treaties and it is expected to be completed by the end of 2016. We believe that treaty negotiations should be deferred until all relevant stakeholders have had an opportunity to reflect on the final text of the MLI and evaluate what it means for them.

The US Model Treaty is a treaty designed for a large economy

The new US model treaty has been designed with the US economy in mind and it will form the basis for US treaty negotiations with all countries, large and small. Businesses operating in larger economies will find it much easier to meet the treaty provisions, particularly those in the LOB.

In essence, the LOB in the Model Treaty is designed to prevent access to tax treaties where an entity is owned or financed from abroad and where its shares are traded on an overseas stock exchange. Businesses in smaller countries, like Ireland, often have very little capital available locally for investment and have a small stock exchange. In addition, businesses with a large global footprint have a geographically dispersed management structure to ensure that some senior staff are located close to its largest markets.

The LOB represents a real challenge for Ireland and, as currently drafted, Irish businesses and funds of all sizes would find it difficult to satisfy any of these tests. Ireland's unique position as a small open economy, one which has a small capital pool and is reliant on significant foreign direct investment, should be acknowledged upfront as part of treaty discussions.

EU law implications

A central theme throughout many of the LOB tests is local ownership. Where companies / funds are not traded on a local stock exchange or are owned primarily by non-resident investors, they will struggle to satisfy any of the LOB tests. There are concerns that the LOB clause may contravene the principles of the fundamental freedoms protected by the European Treaties, and recent proceedings taken by the European Commission indicate that it shares these concerns.

In November 2015, the Commission issued an infringement decision against the Netherlands in respect of the LOB article included in its treaty with Japan. Under this LOB, preferential treaty treatment is granted to public companies listed on local (i.e. Dutch) stock exchanges and to private companies held by resident (i.e. Dutch) shareholders. Comparable companies primarily owned by non-Dutch residents would not be able to avail of treaty benefits. It is reported that the Commission ruled that an EU Member State cannot adopt a bi-lateral tax treaty which provides for more favourable treatment for companies held by residents in its

own territory than for similar companies owned by individuals who are resident elsewhere within the EU. Hence, it considers that the LOB article included in the Dutch-Japan treaty is in breach of EU law.

This ruling is consistent with a decision of the Court of Justice of the European Union ("CJEU") in the "Open Skies" case, in which the court held that nationality requirements included in US treaties with certain EU Member States violated the freedom of establishment.

Under the Model Treaty as drafted, preferential treatment would be granted to companies listed on Irish stock exchanges and to private companies held by resident Irish shareholders. If Ireland was to ratify a treaty with such an LOB, there is a strong possibility that the Commission could launch infringement proceedings against the Irish Government.

In addition, other provisions in the LOB could be a concern from an EU law perspective. In particular;

- Under the Base Erosion Tests, payments made to Irish companies would not have to be taken into account for the Base Erosion Test, while payments made to companies resident in other Member States would be considered base eroding.

- Under the various ownership requirements included in the LOB, indirectly held companies can only avail of treaty benefits to the extent that they are held by QIOs, i.e. residents in EU countries which have signed up to new treaties with the US. Favourable treatment would therefore be granted to Irish companies indirectly held by Irish-resident intermediaries as compared with those companies held by intermediaries in other EU Member States.

  Similarly, the definition of 'equivalent beneficiary', which is relevant for the Derivatives Benefit Test, imposes requirements based on residence.

- Under both the Publicly Traded Company Test and the Headquarters Company Test, favourable treaty benefits are provided to multinational companies whose management are primarily located in Ireland.

Before any new Treaty is agreed, it is important careful consideration is given to the potential EU law ramifications.

Section 4:

Challenges presented by the Limitation on Benefits Article

Challenges presented by the Limitation on Benefits Article

In the preamble to the Model Treaty, the US Department of Treasury notes that the LOB is *"intended to prevent so-called "treaty shopping" by third-country residents that are not intended beneficiaries of the treaty".*

The LOB in the new Model Treaty contains some new provisions, while a number of the pre-existing tests have been tightened. As mentioned above, the tests in the LOB have been designed in the context of larger economies and they would not necessarily represent significant hurdles in US treaty negotiations with other countries.

Ireland's position is unique. Many of the Irish companies and funds who currently rely on the Ireland-US treaty would have difficulty meeting any of these LOB tests in the Model Treaty. While this would have ramifications for these Irish companies, the impact would also be felt in the US economy. Ireland has become an important location for international capital, with Irish investment funds and securitisation companies holding a large portion of international assets. These vehicles are typically funded by international (often US) investors, with Irish residents only accounting for a very small portion of the investor base. If these vehicles are denied treaty access as a result of non-Irish ownership, it would have negative implications for international investment in US assets.

As mentioned above, there are also concerns that the ownership and base erosion tests in the LOB clause may contravene EU law.

We set out below the key challenges with each of the LOB tests and those taxpayers most impacted.

Test 1: The Publicly Traded Company Test

Who currently relies on this test?	Why would the taxpayer find it difficult to pass this test under the Model Treaty?	How widespread is this issue?
Irish Plcs with their primary listing on a non-Irish stock exchange	The listed company must now have its primary listing on the Irish Stock Exchange	Most Irish Plcs have their primary listing on an overseas stock exchange. Currently, Irish Plcs have over 50 listings on overseas exchanges.
Exchange Traded Funds ("ETFs") with their primary listing on a non-Irish stock exchange	The fund must now have its primary listing on the Irish Stock Exchange	More than 50% of all European ETF assets are domiciled in Ireland, with a value of €247 billion. Most of these ETFs are listed on an overseas stock exchange, primarily the Frankfurt and London exchanges.

Overview of new test

The Model Treaty provides that an Irish company / fund shall be entitled to treaty benefits if;

- Its principal class of shares is primarily traded on the **Irish Stock Exchange**, or
- The company's **primary place of management and control** is in Ireland

The Publicly Traded Company Test will be satisfied if either of these tests are met.

Who is impacted by this test?

Companies and funds based in Ireland will, in practice, struggle to meet either of these tests;

1. ***Large Irish Plcs will often have their primary listing on an overseas stock exchange***

Stock exchanges in smaller countries generally do not have large pools of capital, so companies operating in those countries will choose to have their primary listing on an overseas stock exchange. This is particularly true in the case of Irish companies, which have over 50 listings on overseas exchanges. For example, there are;

- 52 on the London Stock Exchange (including the Alternative Investment Market)
- 26 on the NASDAQ
- 9 on the New York Stock Exchange

Note: *Some of these Irish companies are listed across multiple exchanges*

For Irish Plcs with a dual listing, their primary listing will typically be on the overseas exchange. Under the Model Treaty, these companies would not be able to access treaty benefits.

For those Irish companies who have their primary listing on the Irish Stock Exchange and, would therefore currently satisfy this test, it is important that they have the flexibility to list on an overseas stock exchange

should their capital requirements dictate such a move. Under the Model Treaty, a move to an overseas exchange would mean that treaty benefits could no longer be accessed for these companies.

2. ETFs are primarily listed on the Frankfurt and London stock exchanges

ETFs are similar to other stocks and are traded on a stock exchange. More than 50% of all European ETF assets are domiciled in Ireland, with a value of €247 billion. Most of these ETFs are listed on overseas stock exchanges, primarily the Frankfurt and London exchanges.

Institute Recommendation

The stock exchange element of the Publicly Traded Company Test could be widened to include companies and funds where the principal class of its shares is substantially and regularly traded on one or more recognised stock exchanges (specifically including stock exchanges in the EU, European Free Trade Area and the US. Post Brexit, it will also be important to ensure that any definition of a recognised stock exchange includes UK exchanges).

3. Key management will be located near a company's biggest markets

For an Irish Plc to satisfy the Primary Place of Management and Control Test in the Model Treaty;

- The executive officers and senior management employees of the company must 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 Ireland, and
- The staff of the aforementioned management must conduct more of the day-to-day activities necessary for preparing and making those decisions in Ireland, than in any other country.

The application of this test is vague and it has created uncertainty for Irish Plcs and ETFs.

- For Irish Plcs, the Irish market will often account for a very small part of their global operations and this will dictate their executive and management footprint. Even for those Plc's where the majority of the Group's key executives are based in Ireland (e.g. Executive Directors, Non-Executive Directors, Senior Management), a significant portion of the Group's management will be based (or spend a large amount of time) overseas close to their largest markets. For Irish Plcs with a large global footprint, it is unrealistic to expect that the day-to-day operations of all group entities could be managed in Ireland.
- For ETFs, the investment manager will rarely be based in Ireland and will also be required to devote a significant amount of time to the management of other investments. ETFs will not be in a position to satisfy this test.

Institute Recommendation

As part of negotiations on this clause, it would be helpful to agree upfront that operational day-to-day decision making can be devolved to local subsidiaries if the substantive financial and policy decisions for the group are exercised in Ireland.

EU law implications

As mentioned above, the European Commission has issued an infringement decision against the Netherlands in respect of the LOB article included in its treaty with Japan on the basis that it provides

favourable treaty benefits to companies listed on a Dutch Stock Exchange over those listed on another EU exchange.

If Ireland was to agree to an LOB which provides favourable treaty benefits for companies listed on an Irish Stock Exchange and whose key management is based in Ireland, there is a strong possibility that the Commission could launch infringement proceedings against the Irish Government.

Test 2: Subsidiary of Publicly Traded Company Test

Who currently relies on this test?	Why would the taxpayer find it difficult to pass this test under the Model Treaty?	How widespread is this issue?
Subsidiaries of Irish Plcs with their primary listing on a non-Irish stock exchange	As mentioned above, the listed company must now have its primary listing on the Irish Stock Exchange (or for the primary place of management to be in Ireland) for the subsidiary to pass this test.	Most Irish Plcs have their primary listing on an overseas stock exchange. Currently, there are 53 Irish companies listed on overseas exchanges.
Subsidiaries of Irish Plcs with a primary listing on the Irish stock exchange	The subsidiary (and its tested group) must now satisfy a base erosion test.	Given the size of the Irish capital market, it is common for Irish subsidiaries of Plc Groups to source debt finance from outside the country. This would be more prevalent since the Financial Crisis which has limited the lending capacity of Irish banks.
Indirectly held subsidiaries of Irish / US Plcs	The subsidiary must now be held by a QIO.	Irish and US subsidiaries will often be held by intermediate holding companies. This typically occurs where MNCs inherit intermediate holding companies as a result of large acquisitions.

Overview of new test

Subsidiaries of Irish and US Plcs rely on this test to access the current Ireland-US treaty. The Model treaty makes a number of changes to this test. The test is now made up of two elements, both of which must be satisfied;

- An Ownership Test, which requires that at least 50% of the shares in the company must be held by a company which satisfies the Publicly Traded Company Test (Test 1 above). This test also imposes new rules in cases where there is indirect ownership.
- A Base Erosion Test, which requires that at least 50% of the company's payments are made to certain persons (primarily residents in the US or Ireland).

Why would this test be difficult to pass?

A number of the companies who currently rely on this test would find it difficult to pass it under the Model Treaty;

1. ***Irish Plcs are unlikely to pass the Publicly Traded Company Test***

As already mentioned, a significant number of Irish Plcs will not pass the Publicly Traded Company Test by virtue of the fact that (i) their primary listing is on an overseas stock exchange and (ii) day-to-day

management of the Plc Group is exercised overseas. A direct consequence of this is that all Irish and US subsidiaries within these Plc Groups will fail the Subsidiary of a Publicly Traded Company Test.

Institute Recommendation

As stated above, the Publicly Traded Company Test could be widened to include companies where the principal class of its shares is substantially and regularly traded on one or more recognised stock exchanges. This would ensure that its subsidiary companies could access the treaty (subject to other elements of this test being satisfied – see below).

2. Indirect Holding Companies must be resident in a country with a "new" Treaty with the US

The ownership leg of the test requires that, where the subsidiary is held indirectly, each intermediate owner must be resident in either Ireland or the US, or be a QIO. A QIO must be resident in a country which has a "new" treaty with the US (e.g. a treaty which includes provisions on STRs). At the time of writing, only Norway has agreed a new treaty with the US and it is rare that a Norwegian company would hold an Irish company.

Irish and US subsidiaries will often be held by intermediate holding companies. This typically occurs where MNCs inherit intermediate holding companies as a result of large acquisitions. The inclusion of an intermediary anywhere in the ownership chain, which is not resident in Ireland, the US or Norway, would mean that these subsidiaries would fail the Subsidiary of a Publicly Traded Company Test.

Institute Recommendation

To avoid the issues created by indirect ownership, the definition of QIO could be widened to include residents in a country which has a comprehensive treaty with the US or Ireland. If agreement cannot be reached with the US on the exclusion of the 'new treaty' requirement, one possible and more reasonable solution would be to defer the QIO provision until a pre-determined number of territories have signed new treaties with the US.

3. Irish subsidiaries often source finance outside Ireland

Where a company makes certain payments, typically royalties and interest, to certain recipients which account for more than 50% of the company's and its tested group's gross income, it will fail the base erosion leg of this test. Under this test, payments to Irish and US Plcs are disregarded for the base erosion test, however, payments to their Irish and US subsidiaries would be considered base eroding. The reasoning behind this distinction is unclear. Interest and royalty payments to all recipients outside Ireland and the US must be taken into account for the purposes of the Base Erosion Test.

In practice, Irish companies will find it very difficult to pass this test. The following are practical examples of scenarios in which Irish subsidiaries would be impacted;

- An Irish subsidiary of an Irish Plc is used as the group financing company as it has a strong credit rating with financial institutions. It borrows locally from an Irish bank (a subsidiary of a listed bank) and on-lends funds to a number of group entities, including a US company. The third party interest payments being made by the Irish subsidiary would be considered base eroding payments.

- An Irish subsidiary of a Plc borrows funds from a UK sister company (with excess cash) to fund an acquisition. The interest payments being made by the Irish subsidiary would be considered base eroding payments.
- An Irish subsidiary of a US Plc licenses high-value Intellectual Property from an unrelated German company for the purposes of its manufactured products. The royalty payments being made by the Irish subsidiary would be considered base eroding payments.

Institute Recommendation

To alleviate the potential EU law implications (discussed below), it would be advisable that payments made to EU residents are not taken into account for the purposes of the base erosion test. If this approach was agreed with the US, consideration should also be given to excluding the following payments from the Base Erosion Test;

- Payments to residents in Switzerland and EEA countries
- Post Brexit, payments to UK residents

If agreement on this point cannot be reached, perhaps a compromise might be that payments made to EU/EEA/Swiss/UK residents who benefit from an STR could remain subject to the base erosion test.

At a minimum, we believe that the carve out for interest payments made to certain banks under the current Ireland – US Treaty (Article 23(2)(c)(ii)) should be retained. While this clause has worked well in the existing treaty, it is important to recognise that companies no longer rely solely on banks for debt financing and it is becoming more common to borrow from institutional investors. As such, there may be merit in extending this carve out to cover interest payments made to institutional investors.

EU law implications

As mentioned above, the European Commission has issued an infringement decision against the Netherlands in respect of the LOB article included in its treaty with Japan on the basis that it provides favourable treaty benefits to companies listed on a Dutch Stock Exchange over those listed on another EU exchange.

If Ireland was to agree to an LOB which provides favourable treaty benefits for companies held by Irish residents and who source finance from Irish banks, there is a strong possibility that the Commission could launch infringement proceedings against the Irish Government.

Test 3: Ownership Test

Who currently relies on this test?	Why would the taxpayer find it difficult to pass this test under the Model Treaty?	How widespread is this issue?
Privately owned companies	More than 50% of the shares must now be held by Irish residents and there are new restrictions in cases where these shares are held indirectly. =============== In addition, the company (and its tested group) must now also satisfy a stricter base erosion test. Companies which make large interest payments to non-Irish / US Plcs would fail this test.	The capital market in Ireland is too small so companies rely on overseas investors for additional finance. =============== It is common for private Irish companies to source debt finance from outside the country.
Privately held funds and securitisation companies	As above, more than 50% of the investors in the fund must be Irish resident.	Most funds are owned by foreign investors. It is estimated that Irish investors account for less than 1% of investors in Irish funds.

Who is impacted by this test?

As with Test 2 above, this test is now made up of two elements, both of which must be satisfied;

- An Ownership Test, which requires that at least 50% of the shares in the company must be held by Irish residents. This test also imposes new rules in cases where there is indirect ownership.
- A Base Erosion Test, which requires that at least 50% of the company's payments are made to certain persons (primarily residents in the US or Ireland).

Why would this test be difficult to pass?

For privately owned companies and funds, the Ownership and Base Erosion Tests above are reasonably straightforward to meet in the case of companies operating in large economies. These companies are generally owned and financed domestically due to the availability of significant domestic capital. However, it would be difficult for Irish companies / funds to satisfy these tests.

1. Many Irish companies / funds will be owned by foreign investors

In smaller economies like Ireland, where there is a limited capital pool, companies seeking investment will be heavily reliant on foreign investment. Take an example of a high potential Irish start-up, founded and owned by two Irish residents, which is looking for investment to fund its expansion into the US market. If the capital is provided by a UK-resident angel investor by way of a 51% equity investment, the Irish company would fail the Ownership Test.

Similarly, most Irish domiciled funds are held by non-resident Investors. Irish funds are sold into 70 different countries and have a geographically disperse investor base. It is estimated that Irish investors account for only 1% of investors in Irish funds.

Institute Recommendation

Under the existing Ireland – US treaty, the Ownership Test can generally be satisfied if the shares are owned by either Irish or US residents. We believe that the Ownership Test in the Model Treaty should also allow for either Irish or US ownership.

2. *Indirect Holding Companies must be resident in a country with a "new" Treaty with the US*

Even where private companies and funds are owned primarily by Irish investors, these investments can often be held by intermediary holding companies. The requirement that each intermediary be a QIO means that many of these companies and funds would fail the Ownership Test.

Institute Recommendation

To avoid the issues created by indirect ownership, the definition of QIO could be widened to include residents in a country which has a comprehensive treaty with the US or Ireland. If agreement cannot be reached with the US on the exclusion of the 'new treaty' requirement, one possible and more reasonable solution would be to defer the QIO provision until a pre-determined number of territories have signed new treaties with the US.

3. *Private Companies often source debt finance outside Ireland*

Similar to the position for subsidiaries of Irish Plcs, the limited capacity of Irish banks means that private companies will often have to source debt finance from non-Irish institutions. Where an Irish company makes large interest payments to non-Irish and non-US banks, it may fail the Base Erosion Test. Even payments made to subsidiaries of Irish and US banks would appear to be considered base eroding payments.

Institute Recommendation

To alleviate the potential EU law implications (discussed below), it would be advisable that payments made to EU residents are not taken into account for the purposes of the base erosion test. If this approach was agreed with the US, consideration should also be given to excluding the following payments from the Base Erosion Test;

- Payments to residents in Switzerland and EEA countries
- Post Brexit, payments to UK residents

If agreement on this point cannot be reached, perhaps a compromise might be that payments made to EU/EEA/Swiss/UK residents who benefit from an STR could remain subject to the base erosion test.

At a minimum, we believe that the carve out for interest payments made to certain banks under the current Ireland – US Treaty (Article 23(2)(c)(ii)) should be retained. While this clause has worked well in the existing treaty, it is important to recognise that companies no longer rely solely on banks for debt financing and it is becoming more common to borrow from institutional investors. As such, there may be merit in extending this carve out to cover interest payments made to institutional investors.

EU law implications

As mentioned above, the European Commission has issued an infringement decision against the Netherlands in respect of the LOB article included in its treaty with Japan on the basis that it provides favourable treaty benefits to companies listed on a Dutch Stock Exchange over those listed on another EU exchange.

If Ireland was to agree to an LOB which provides favourable treaty benefits for companies held by Irish residents and who source finance from Irish banks, there is a strong possibility that the Commission could launch infringement proceedings against the Irish Government.

Test 4: Derivative Benefits Test

Who currently relies on this test?	Why would the taxpayer find it difficult to pass this test under the Model Treaty?	How widespread is this issue?
Indirectly held private companies	The company must now be held by a QIO.	For a variety of commercial reasons, investors often hold investment through intermediate holding companies.
Indirectly held funds	The company must now be held by a QIO.	Investments in funds are held through intermediate holding companies. Some funds use different holding companies to segregate ownership by reference to the geographical location of investors.

Overview of new test

The Derivative Benefits test is made up of two elements, both of which must be satisfied;

- An Ownership Test, which requires that 95% of the shares are owned directly by 7 or fewer "equivalent beneficiaries". Each intermediate owner of the shares must be a QIO.
- A Base Erosion Test, which requires that at least 50% of the company's payments are made to equivalent beneficiaries.

Who is impacted by this test?

The availability of a broad based Derivative Benefits Test is essential if the LOB is to operate effectively for businesses based in Ireland. There are a number of provisions in the Model Treaty which make this test difficult to pass;

1. ***Indirect Holding Companies must be resident in a country with a "new" Treaty with the US***

The requirement that each intermediary in the ownership chain be a QIO means that many of these companies and funds would fail the Ownership Test.

Institute Recommendation

To avoid the issues created by indirect ownership, the definition of QIO could be widened to include residents in a country which has a comprehensive treaty with the US or Ireland. If agreement cannot be reached with the US on the exclusion of the 'new treaty' requirement, one possible and more reasonable solution would be to defer the QIO provision until a pre-determined number of territories have signed new treaties with the US.

2. The number of equivalent beneficiaries is limited to seven

The requirement to limit the number of equivalent beneficiaries to a maximum of seven could have a widespread impact.

- Private companies often operate share-based remuneration schemes in an effort to retain and incentivise key staff. Under such schemes, often more than 5% of the companies' shares would be awarded to staff. This would mean that the 95% threshold in this test could not be met.
- Similarly, in a family owned business, the ownership may be attributed across a wide range of family members.
- Funds are widely held vehicles and in generally they would be owned by more than seven investors.

Institute Recommendation

We believe that there should be no limit on the number of equivalent beneficiaries to satisfy this test once, for example, all shareholders are equivalent beneficiaries. Particularly, in a family business scenario, one solution might be to aggregate the shareholding of family members and the treat the family as one equivalent beneficiary.

EU law implications

As mentioned above, the European Commission has issued an infringement decision against the Netherlands in respect of the LOB included in its treaty with Japan on the basis that it provides favourable treaty benefits to companies listed on a Dutch Stock Exchange over those listed on another EU exchange.

If Ireland was to agree to an LOB article which provides favourable treaty benefits for companies and funds held by Irish residents, there is a strong possibility that the Commission could launch infringement proceedings against the Irish Government.

Test 5: Active Trade or Business Test

Who currently relies on this test?	Why would the taxpayer find it difficult to pass this test under the Model Treaty?	How widespread is this issue?
In many cases, subsidiaries of Plcs and private companies would have been able to rely on the "Active Trade or Business Test" as an alternative test (if the other tests could not be satisfied).	Some subjective wording has now been included in the Model Treaty and companies are unclear whether they will be able to rely on it.	The tightening of other tests in the LOB means that a significant number companies may be forced to rely on this test going forward.

Overview of new test

The Model Treaty provides that an Irish company will pass this test if it is engaged in the "active conduct of a trade or business" in Ireland, and the income derived from the US "emanates from, or is incidental to", that trade or business carried on in Ireland. In addition, where income is received from a trade in the US or from a connected party in the US, the treaty benefits will only apply where the trade carried on in Ireland is "substantial" in relation to the activity carried on in the US.

The Model Treaty expressly states that the following activities shall not constitute a trade or business;

- operating as a holding company;
- providing overall supervision or administration of a group of companies;
- providing group financing (including cash pooling); or
- making or managing investments, unless these activities are carried on by a bank, insurance company or registered securities dealer in the ordinary course of its business as such.

Who is impacted by this test?

The Active Trade or Business Test is important for companies operating in a small economy like Ireland. The tightening of other tests in the LOB article means that this test will become more important for companies.

The precise meaning and application of the terms "emanates from" and "substantial" is unclear, as is the scope of the exclusions relating to supervision/administration and group financing activities.

There are real concerns that substantive trades being carried on in Ireland could fail this test. In particular, where income is derived from a connected party, the requirement that the activity carried on in Ireland must be substantial in relation to the trade carried on in the US would be difficult to meet given the difference in the scale of economies / markets of both countries.

Feedback from our members indicates that many small country operations that would have been expected to satisfy this test have, in practice, found it difficult to meet in the context of other US tax treaties.

Institute Recommendation

In the preamble to the Model Treaty, the US Department of Treasury note that a "technical explanation of the 2016 Model" would be released in Spring in which guidance would be provided on the meaning of these terms. No technical explanation has been released to date.

As part of negotiations, it would be helpful if upfront clarity is provided by the US on the practical application of this test so that the full impact on Irish companies can be assessed. Examples of companies who pass this test would also be welcomed particularly for certain industries like leasing.

Test 6: Headquarters Company Test

Who could theoretically rely on this test?	Why would this test be difficult to pass?	How widespread is this issue?
Multinational Companies	There is a requirement to have entities operating across four countries, each of which must account for 10% of the MNC group's gross income. ============ No more than 50% of the MNC Group's gross income can be derived in one country (apart from the home country). ============ Less than 25% of the company's gross income must be derived in one country.	For recently established MNC's, it would be difficult to establish a substantial footprint across a number of territories ============ In certain sectors, Irish companies will be highly reliant on one single market. For example, the UK accounts for; • 42% of Irish food and drink exports • 55% of Irish exports in the timber and construction sectors • Almost 50% of Irish clean technology and electronics exports

Who is impacted by this test?

The Headquarters Company Test would represent a completely new test for the existing Ireland-US Treaty. This test contains six elements, each of which must be satisfied. Three elements in particular would make it very difficult for Irish companies to pass;

1. ***Four subsidiaries test***

The Headquarters Company is required to own subsidiaries which are engaged in an active trade or business in at least four other territories, with each of the trades or businesses accounting for at least 10% of the group's gross income.

In the early stages of their lifecycle, MNC's typically focus on one or two primary markets. These companies would struggle to generate a sufficient level of turnover across four jurisdictions.

2. ***50% of the MNC's gross income cannot be generated from one single market***

The Headquarters Company Test cannot be satisfied where more than 50% of the MNC's gross income is generated from one single country (apart from its country of residence).

Certain Irish industries are often reliant on one large market. For example;

- The pharma sector generates most of its income from the US
- The agri-food sector exports most of its goods to the UK

Most companies operating within these sectors would fail the Headquarters Company Test.

3. No more than 25% of the company's gross income cannot be generated from the US

As mentioned above, the US represents one of the largest export markets for Ireland's pharma industry. Given the size of the US population, Irish multinational companies spanning a range of industries would be heavily reliant on the US market. Many of these companies would easily breach the 25% threshold.

Institute Recommendation

Currently, it is difficult to envisage many Irish companies gaining access to the Treaty by virtue of this test. As part of treaty negotiations, it would be useful to revisit the relevant thresholds to ensure that this test could have some application for Irish companies.

EU law implications

As mentioned above, the European Commission has issued an infringement decision against the Netherlands in respect of the LOB article included in its treaty with Japan on the basis that it provides favourable treaty benefits to companies listed on a Dutch Stock Exchange over those listed on another EU exchange.

If Ireland was to agree to an LOB which provides favourable treaty benefits for companies held by whose management are located in Ireland, there is a strong possibility that the Commission could launch infringement proceedings against the Irish Government.

Section 5:

Other important points to consider

Special Tax Regimes

The Model Treaty introduces the concept of Special Tax Regimes ("STRs") which is defined in Article 3. Where certain payments of interest, royalties, and guarantee fees are subject to preferential tax treatment (i.e. an STR) in the recipient's country of residence, the treaty reductions in withholding tax will not apply to such payments.

With the exception of Tonnage Tax (discussed below), it is our understanding that Ireland does not currently operate any preferential regimes which would fall within the Treaty definition of an STR. It is important that there is upfront agreement with the US on this issue. Similarly, the Irish negotiating team should seek clarity on the STRs in operation in the US.

As mentioned, Ireland's Tonnage Tax regime has been identified as a possible STR. We also understand that a similar regime operates in the US. As part of negotiations, it might be helpful to seek equivalent treaty treatment for all Irish and US companies availing of the regimes in both countries.

Other points for consideration

Dividend Withholding Tax

Article 10 of the Model Treaty and the existing Ireland-US Tax Treaty both provide for a reduced rate of Dividend Withholding Tax of 5%. Some US bi-lateral treaties provide for zero withholding tax on dividends where similar conditions are met. For example, this applies in the US-UK Treaty.

A zero rate withholding tax might be something that is considered in the context of the new Ireland-US Treaty. This is particularly important as regards withholding tax on dividends paid to pension funds, which is currently provided for in the Model Treaty.

Collective Investment Undertaking

Collective Investment Undertakings are an important investment vehicle. They offer small investors increased liquidity, risk diversification and economies of scale that they would not otherwise be able to achieve.

Article 4(1)(d) of the existing Ireland-US Treaty considers that Collective Investment Undertakings are considered resident in Ireland. This clause should be retained in the new treaty.

US Section 385 regulations

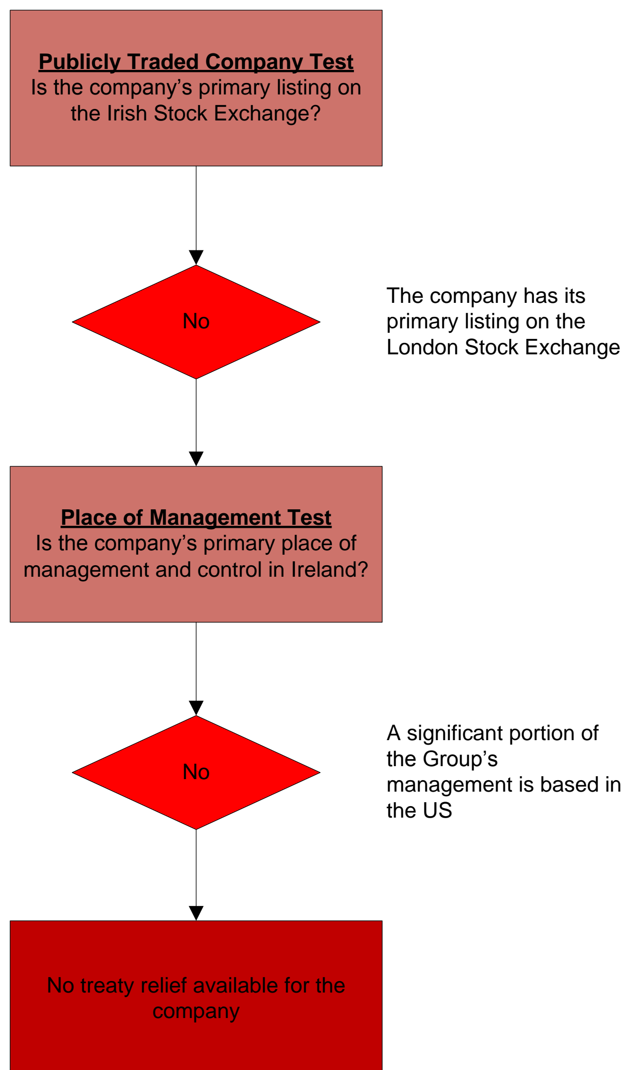
The new US Section 385 regulations seek to deny a deduction for certain related party interest. However, the interest income would be taxable in Ireland, resulting in a mismatch between the Irish and US treatment. While this is not an issue specific to the Model Treaty, we believe that it should also be considered as part of the treaty negotiation

Section 6:

Case Studies

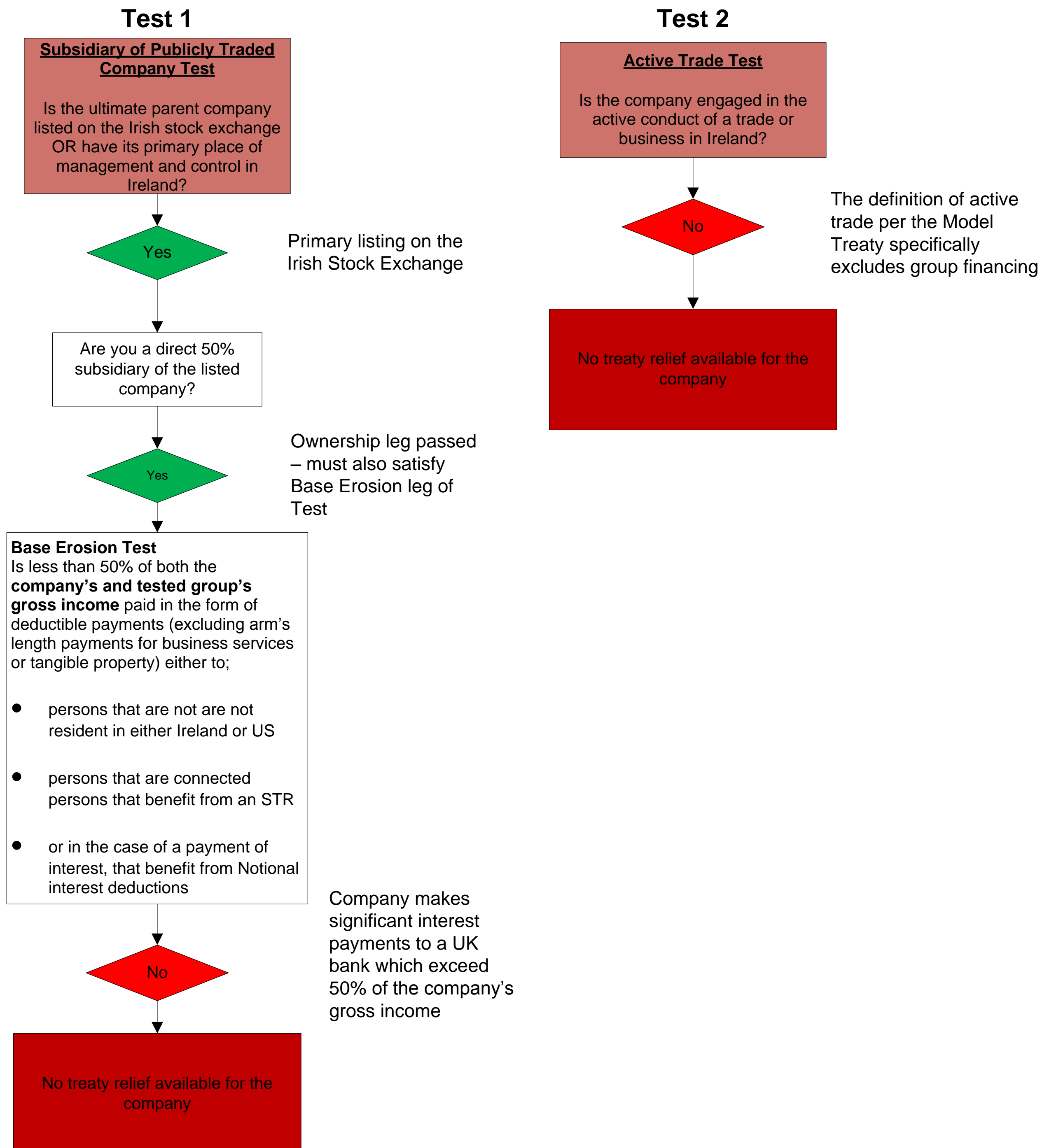
Case Study 1: Irish Plc

- The Plc (holding company) had its primary listing on the Irish Stock Exchange for 15 years
- In 2013, it moved its primary listing to the London Stock Exchange to raise additional capital.
- This capital was used to fund the Group's expansion, in particular the acquisition of a major US MNC.
- The US now accounts for almost 60% of the Group's entire business. It has moved key management to the US to manage the day-to-day operations



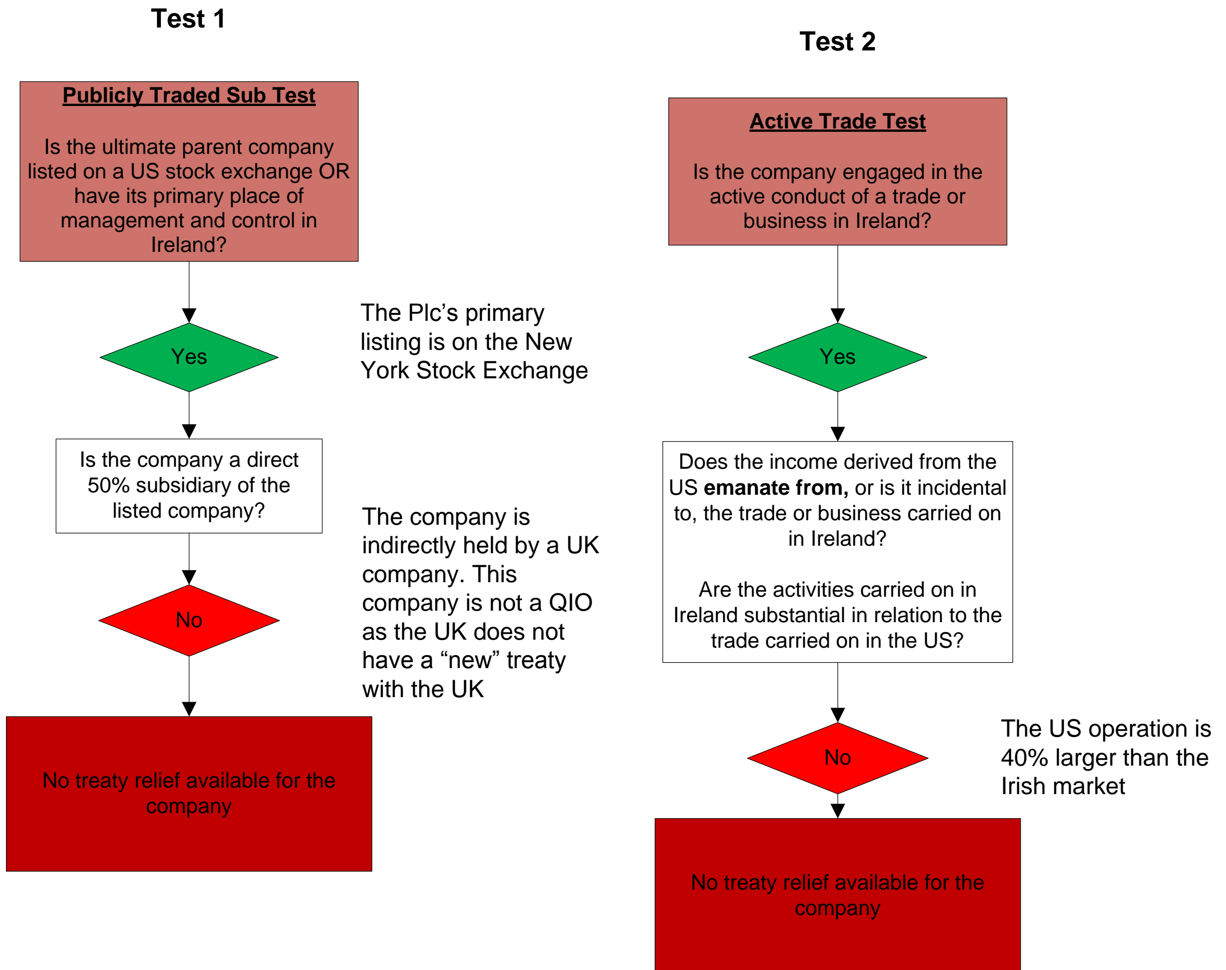
Case Study 2: Subsidiary of Irish Plc

- The company is an Irish resident direct subsidiary of the Irish Plc which has its primary listing on the Irish Stock Exchange
- The subsidiary is the Group's financing company. It borrows from a UK bank and on-lends funds to a number of group entities, including a US company.
- The third party interest payments being made by the Irish subsidiary would be considered base eroding payments.



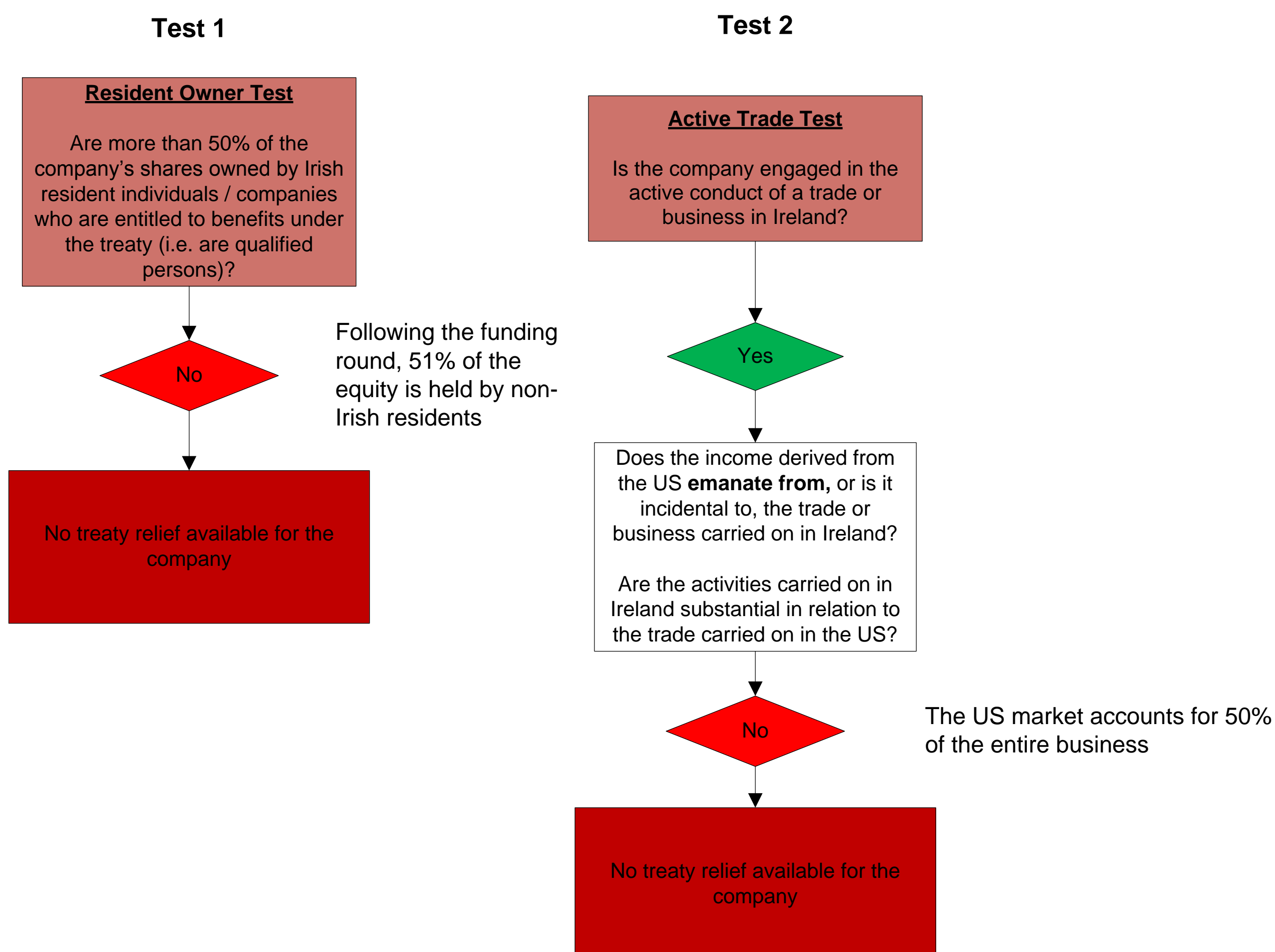
Case Study 3: Subsidiary of US Plc

- The company is an Irish resident indirect subsidiary of US Plc which has its primary listing on the New York Stock Exchange
- The company is part of the Plc's technology business, a business which was acquired following a merger with UKtech Ltd in 2014
- The company is held by a UK Holdco, a legacy holding company in the UKtech Ltd Group
- The company receives sales income from a connected company which is resident in the US



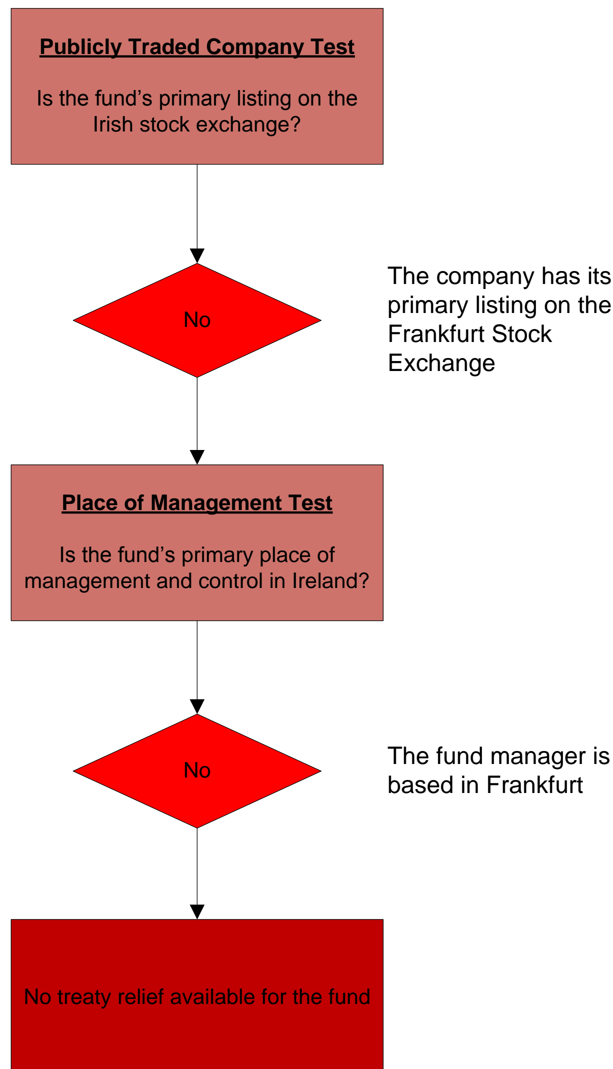
Case Study 4: Privately owned Irish company

- A high potential Irish start-up was founded by two Irish residents in 2010. These are the company's only shareholders.
- The company has a large presence in the US market and is looking for investment to fund its entry into the Asian market.
- A London-based venture capital house acquires a 51% equity investment in the company, providing the company with the capital required to develop the Asian market



Case Study 5: Exchange Traded Fund

- The ETF is domiciled in Ireland but is listed on the Frankfurt Stock Exchange
- The fund's investment manager is based in Frankfurt



Leaders in Tax

South Block
Longboat Quay
Grand Canal Harbour
Dublin 2
Ireland

T: +353 1 663 1700
F: +353 1 668 8387

E: info@taxinstitute.ie
W: www.taxinstitute.ie