United States

US Treasury Department releases proposed updates to US Model Income Tax Convention – details

22 May 2015

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The proposed updates include the following five sets of draft provisions:

**Exempt permanent establishments**

The first set of draft provisions (Proposed Treaty Rule Addressing So-Called "Exempt Permanent Establishments" (5-20-2015)) provides rules on the treatment of income earned in a country by a resident of its treaty partner country in situations where the income is not subject to tax in the treaty partner country, because it is earned through a permanent establishment situated in a third country, with the third country imposing a low or zero rate of tax on the income of the permanent establishment. The draft provisions specify two circumstances under which the new rules will be applied. The rules are intended to reduce base erosion and profit shifting (BEPS) by preventing residents of third countries from inappropriately obtaining the benefits of a bilateral tax treaty.

The first set includes new article 1(7) (General Scope).

**Expatriated entities**

The second set of draft provisions (Proposed Treasury Rules Addressing Payment by "Expatriated Entities" (5-20-2015)) provides rules denying treaty benefits to US companies that change tax residence in a corporate inversion transaction. The new provisions would impose full US withholding taxes on dividends, interest, royalties and other income paid by US companies that are "expatriated entities", as defined in section 7874(a)(2)(A) of the US Internal Revenue Code (IRC). Withholding would apply for a 10-year period following the date of the expatriation.

The second set includes new articles 10(9) (Dividends), 11(2)(d) (Interest), 12(5)(b) (Royalties) and 21(3)(b) (Other Income).

**Special tax regimes**

The third set of draft provisions (Proposed Treaty Rules Addressing "Special Tax Regimes" (5-20-2015)) provides rules intended to prevent taxpayers from using provisions in tax treaties and "special tax regimes" to generate stateless income or double non-taxation. The term special tax regime refers to legislation, regulations or administrative practices that provide a preferential effective rate of taxation with respect to an item of income or profit, particularly mobile income such as royalties and interest.

The third set includes new article 3(1)(l) (General Definitions) and related provisions for the new Model Protocol, in addition to new articles 11(2)(c) (Interest), 12(5)(1) (Royalties), and 21(3)(a) (Other Income).

**LOB rule for derivative benefits**

The fourth set of draft provisions (Proposed Limitation on Benefits Article (5-20-2015)) provides a new, taxpayer-favourable rule on limitation on benefits (LOB), referred to as a "derivative benefits" rule. The derivative benefits rule is an additional method of qualifying for treaty benefits based on a broader concept of ownership including certain third-country ownership, generally applying to determine whether a holding company or financing entity qualifies for treaty benefits.

The fourth set includes new article 22 (Limitation on Benefits). According to the Treasury Department, an advance draft Technical Explanation of the revised article 22 has not been released, and is not expected to be released, because the rules are objective and mechanical in nature and thus are self-explanatory.

**Subsequent changes in law**

The fifth set of draft provisions (Proposed Article Addressing Subsequent Changes in Law (5-20-2015)) provides rules intended to enable the United States to maintain the balance of benefits negotiated under its treaty network as the tax laws of treaty partners change over time, sometimes in ways that encourage BEPS by multinational companies.

The fifth set includes new article 28 (Subsequent changes in law), which specifies the types of changes in law that will trigger application of the provisions.
The press release notes that the Treasury Department intends to include in the next US Model Income Tax Convention a new article to resolve disputes between tax authorities through mandatory binding arbitration.

The Treasury Department requested public comments on the proposed treaty rules and stated that comments received would be taken into account as the revisions are finalized.

See also

United States-3, News 21 May 2015
United States - Corporate Taxation - Country Analyses section 7.4.1.
United States - Individual Taxation - Country Analyses section 7.4.1.