Selected Double Tax Treaty Agreements

Issues and Updates

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Agenda

• Tax Treaty Basics
• Exchange of Information Issues
• US & UK Income Tax Treaties and Updates
  • Switzerland, Germany, France, Italy, Spain
  • US Treaty Protocols
• 2016 US Model Treaty
Overview

- Income Tax Treaties
  - Taxation of income
- Contrast other treaties and agreements:
  - Gift & Estate Tax
  - Tax Information Exchange Agreements – limited to information exchange
  - Social Security Agreements – harmonization of state pension programs
Purpose & Background

- **Purpose of Income Tax Treaties**
  - Help eliminate double taxation of income arising from one State earned by residents of the other State
  - Greater certainty of treatment of cross-border trade and investment income generated
  - Prevent excessive foreign taxation and other forms of discrimination against overseas business interests (reduced rates)
  - Also prevent non-taxation and tax evasion
  - Exchange of information

- Over 3,000 double-tax treaties in place today

- **US & UK tax treaty networks**
  - US – focus on Europe, Asian countries with focus on direct foreign investment, appx. 70 treaties in force
  - UK – largest network, 120+ treaties in force
Taxes Covered

- Taxes on income
- Generally all levels of government
  - Except US – limited to federal income taxes and insurance excise tax
  - Tax treaty provisions may or may not be honored by US States on state-source income
- Also applies to any identical or substantially similar taxes which are imposed after the date of signature
  - Competent authorities to notify re: significant changes in tax laws
Tax Residence

- “any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, nationality, place of management, place of incorporation, or any other criterion of a similar nature”

- "resident of a Contracting State" does not include any person who is liable to tax in that State in respect only of income from sources in that State
  - UK resident non-domiciliaries

- US: exception also for Swiss lump-sum taxpayers unless they elect to be subject to the generally imposed Swiss income taxes on all U.S.-source income
Tax Residence

– Resident of both States?
– Tie-breakers
  1. Permanent home
  2. Center of vital interests
  3. Habitual abode
  4. National
  5. Competent authorities – mutual agreement
Limitation on Benefits

- US limitation on benefits clauses
- Eligibility:
  - Resident individuals
  - State entities
  - Active conduct of trade or business, and income in other State is derived in connection with, or incidental to, that trade or business
  - Headquarters company for multinational group
  - Regularly traded
  - Company or trust owned predominantly by eligible persons (other ownership thresholds may apply for certain income types)
Relief from Double Taxation

- State of residence agrees to exempt income taxed by other State
- US: savings clause
  - Where resident is also citizen of United States and subject to US income taxation
  - US to allow income tax credit as appropriate
- Also non-discrimination clause
  - Not less favorable treatment than nationals of State in same circumstances
  - Also applies to permanent establishments
Beneficial Treaty Rates on Income

– Income from real property: may be taxed in other State (non-residence State) where property situated
– Business profits: taxable only in State of residence (unless permanent establishment in other State)
– Dividends: typically 15% reduced rate (5% if 10%-owned company)
– Interest, royalties: State of residence only
– Caveat: different treaties, different treatment and rates
– Specific provisions on Gains, Personal Services, Pensions and Annuities, other income types
Permanent Establishment

– Exception to non-taxation of business profits in State of non-residence

– Business profits attributable to PE taxable in other State as though a distinct enterprise

– Fixed place of business, includes specifically:
  ▪ place of management; branch; office; factory; workshop; etc.
  ▪ Exceptions for certain activities, including those which have a “preparatory or auxiliary character”

– Services of dependent agent may result in PE (Services PE)
  ▪ Execution of contracts
  ▪ Contrast independent agents, including brokers, etc. acting in ordinary course of business

– Does not include company resident in State (subsidiary)
Exchange of Information
Issues
Scope of Information Exchange

• Mutual Legal Assistance Treaties (MLAT)
• Global Forum on Transparency and Exchange of Information (Global Forum)
• Tax Information Exchange Agreements (TIEA)
• Double Taxation Agreements (DTA)
• Convention on Mutual Administrative Assistance in Tax Matters (amended by Protocol in 2010), including automatic exchanges but without scope or procedure
• Multilateral Competent Authority Agreement (MCAA)
  • on Automatic Exchange of Financial Account Information
  • on the Exchange of CbC Reports
Confidentiality Issues

- Confidentiality
  - US-Switzerland 2009 Protocol
  - 2016 Model US Treaty
Income Tax Treaties and Updates
# US & UK Income Tax Treaties

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US-Switzerland – Updates

  - Modernize rules re: exchange of information
    - Arose from 2008-2009 investigations
    - Broader application, not limited to tax fraud and the like
      - No other US treaty uses this standard
    - US may obtain whether Switzerland needs information for own tax administration purposes
  - Bank secrecy not a shield to exchange of information
  - Not intended for bulk collection of information
    - Limited to targeted investigations: information sufficient to identify the person under examination or investigation (but name not always required!)
  - US will receive bulk information anyway under FATCA
US-Switzerland – Updates

- Mandatory arbitration rule
  - Opportunity for taxpayer participation by providing information directly to arbitral panel with position papers
  - No employee of own tax administrations on panel
  - Consistent with 2016 Model and provisions in force with Germany, France, Canada, Belgium

- Exemption from source country withholding on dividends paid to individual retirement accounts (requested by Switzerland)

- Claiming Treaty Benefits
  - Updates to IRS Form W-8BEN-E
  - Other Form W-8 Issues
US-Swiss Estate Tax Treaty

- Increased exemption amount for US estate tax purposes; disclosure of worldwide assets

- Example: Swiss citizen/domiciliary decedent:
  - **US situs** assets in estate: $1,000,000 (10%)
  - **Non-US situs** assets in estate: $9,000,000 (90%)
  - Treaty exemption for US estate purposes: 10% of $ 5,450,000 (exemption for US citizens) so $545,000 is exempt
  - Assets subject to US estate tax after exemption: $1,000,000 (US situs) - $545,000 (exempt) = $455,000
  - US estate tax: $140,500 (at 18%-34%)
UK-Switzerland Income Tax Treaty

– Signed 1977
– 2009 amendment: mutual agreement procedure, exchange of information (foreseeably relevant, on request)
– Resident does not include any person who is liable to tax in UK in respect only of income from sources in UK
– 0% withholding on interest
– 0% withholding on UK dividends if Swiss company controls at least 10% directly or indirectly; otherwise 15% withholding
UK-Spain Income Tax Treaty

- Entered into force in June 2014

 Residents Non-Domiciled in the UK (Article 23)
  - Anti-abuse clause affecting the position of Residents Non-Domiciled ("RND") in the UK and subject to tax on a remittance basis
  - Tax reduction or exemption in Spain applies only to so much of the income, profit, or gain as is taxed in the UK
UK-Spain Double Tax Treaty (DTT)

- **Trusts (Articles 3 and 4)**
  - The term "person" includes an individual, a trust, a company, or any other body of persons
  - Specific rules to determine when DTT applies in structures involving *trusts* established in the UK or third countries
UK-Spain Double Tax Treaty (DTT)

- Absence of Withholding Tax on Royalties/Interests/Dividends (Articles 10, 11 and 12)
  - 0% withholding tax on royalties, interest, and dividends received from qualifying subsidiaries (at least 10%)
  - 10% or 15% withholding tax to dividend distributions from non-qualifying participations or real estate companies where more than 50% of their value derives, either directly or indirectly, from real estate (specifically exempt REITs)
UK-Spain Double Tax Treaty (DTT)

- Real Estate Companies (Articles 10 and 13)
  - Income and capital gains arising from real estate companies are taxed in the jurisdiction where the real estate is located
  - UK residents owning Spanish real estate companies may be subject to the wealth tax in Spain
UK-Spain Double Tax Treaty (DTT)

- Mutual Agreement Procedure and Exchange of Information (Articles 25 and 26)
  - New mechanism for taxpayers to resolve any tax issue arising from the DTT provisions through an arbitration procedure
  - New exchange of information clause fully in line with current OECD Model standards
Other Treaties

  - New Article 7 (Business Profits) to conform to OECD Model Convention
  - Harmonizes taxation rights under government service and diplomatic missions articles with the UK-Germany Consular Convention
- Other UK Protocols and DTAs in progress
  - None announced for Switzerland, France, Italy
  - US and UK working toward OECD BEPS implementation
UK: Post-Brexit Impact

– Post-Brexit: to qualify for derivative treaty benefits under limitation of benefits articles – third-country treaties: subsidiary with equivalent beneficiary owner that must be a member of the EU or EEA

– EU directives on interest and royalties (2003/49), mergers (2009/133), mutual assistance (2010/24), exchange of information (2011/16), and parent and subsidiaries (2011/960)

– EU automatic exchange of tax ruling
OECD Action Plan

- US and UK implementation of OECD BEPS Action Plan
  - Treaty implementation
- Proposed measures
  - Action 2: Hybrid mismatches
  - Action 4: Limit base erosion via interest deductions and other financial payments
  - Action 5: Preferential tax regimes
  - Action 6: Treaty abuse
  - Action 7: Artificial avoidance of PE status
  - Action 14: More effective dispute resolution mechanisms
    - MAP (Mutual Agreement Procedure) provisions
  - Action 15: Develop a multilateral instrument
    - To modify bilateral tax treaties in a synchronized and efficient manner
Updates – 2016 US Model Treaty

- First update since 2006
- Basis for US negotiation of tax treaties
- Technical improvements, most are not substantive changes
- Some changes to address double taxation possibilities and areas of double non-taxation
2016 US Model – Special Tax Regimes

- Special Tax Regimes (STR) Provision
  - Mitigate instances of double non-taxation where taxpayer uses provisions in tax treaty, combined with special tax regimes, to pay low or no tax in either treaty country
  - In line with OECD BEPS initiative
  - Objective standard, prospective basis only

- Application of STR
  - Preferential tax rate for related-party interest or royalty payments or guarantee fees
  - Permanent reduction in tax base
  - Low rate of taxation (less than 15% or 60% of general statutory rate in other Contracting State)
  - Exceptions for certain R&D, pensions, charities, limited deferral for regulated investment entities and real estate holdings

- US preserves power to tax in case of STR
2016 US Model – Anti-Inversion Measures

- Provisions to reduce benefits of corporate inversions by denying treaty benefits on US source dividends, interest, royalties, and certain guarantee fees paid by US companies that are “expatriated entities” (as defined by IRS)
  - Defined IRC § 7874: inverted company (US Co acquired by non-US Co) and afterward 60 percent of stock by vote or value is held by former shareholders of US Co
  - Also applies to partnership interests
  - Meaning fixed as of date of signature of Treaty (no treaty override)
- Exception for pre-existing US subsidiaries of foreign acquirer
- Ten-year tax tail in United States (no treaty benefits during this time)
  - In line with US domestic treatment of inverted corporations
2016 US Model – LOB Revisions

- LOB provisions designed to prevent “treaty shopping” where third-country resident routes investment into US through treaty country to benefit from reduced withholding rates

- Active trade or business test
  - Requires factual connection between active trade or business in the residence country and item of income for which benefits are sought

- Derivative benefits test
  - 95% of shares must be owned by “equivalent beneficiaries” eligible for benefits under the same or another treaty with the US
  - Removes existing geographic restriction in place with existing US treaties with EU countries

- Headquarters company test
  - Companies that serve as active headquarters company of multinational corporate group eligible for treaty benefits
  - Must exercise primary management and control functions and be sufficiently distributed (true multinational)
2016 US Model – Other Changes

- Mandatory Binding Arbitration
  - Certain disputes between tax authorities to be resolved through mandatory binding arbitration
  - “last-best offer” arbitration approach (in four existing US tax treaties and three awaiting Senate ratification)

- Subsequent Changes in Law
  - Address situations where Contracting State changes law to no longer impose significant tax on cross-border income of resident companies (see Special Tax Regimes)
  - Individuals subject to remittance or lump-sum taxation addressed in other provisions
2016 US Model – Other Changes

- OECD-G20 BEPS Initiative Implementation
  - Revised preamble to make clear the intentions of treaty partners that the purpose of a tax treaty is the elimination of double taxation with respect to taxes on income without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance
  - Rule to protect against contract-splitting abuses of twelve-month permanent establishment threshold for building sites or construction or installation projects
  - Twelve-month ownership requirement for five-percent withholding rate for direct dividends, with a twelve-month residence requirement to prevent companies from circumventing the ownership period

- BEPS Recommendations *not* implemented
  - Other measures for permanent establishment threshold, including revised rules related to dependent and independent agents and exemption for preparatory and auxiliary activities
  - Concerns re: consistency of enforcement and implementation, compliance burdens
Questions?
Gregory Walsh is co-head of the FATCA/CRS practice at Baker & McKenzie in Switzerland and a member of the International Tax and Global Wealth Management practice groups. He also has experience advising clients in corporate and securities matters.

Mr. Walsh focuses his practice on international tax planning and global wealth management matters. He advises clients on trust and company structures, FATCA and CRS compliance, US withholding tax and QI compliance, individual and corporate tax planning, financial institution tax compliance and tax regularization matters. Prior to developing his tax and wealth management practice, Mr. Walsh advised clients in diverse corporate law issues including mergers and acquisitions, securities transactions and compliance, corporate governance and commercial transactions.

Lyubomir Georgiev has close to 10 years of experience assisting banks, fiduciaries, insurance companies and high net worth individuals in the following areas: wealth management planning, taxation, withholding, disclosure, filings, and regulatory compliance. He is ranked in Chambers Global as a Foreign Expert based in Switzerland for UK and US private clients, UK and Liechtenstein tax, and general business law. Previously he has worked in Washington, DC and New York. He is admitted to practice in the District of Columbia (USA), the US Tax Court, England & Wales, and in Switzerland (as a foreign-qualified solicitor).

Mr. Georgiev regularly advises on issues relating to FATCA, OECD CRS, FATF, BEPS, international taxation, life insurance and annuity products, trust planning, expatriation, executive relocation, withholding and information exchange agreements. His practice focuses on institutional and individual clients with US, UK, Swiss, Liechtenstein, Bulgarian and Russian connections.