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November 16, 2015

The Honorable Mark Mazur
Assistant Secretary
(Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable John Koskinen
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Report No. 1331 Relating to the Proposed Revisions to the Limitation on Benefits Article of the U.S. Model Tax Convention

Dear Messrs. Mazur, Koskinen and Wilkins:

I am pleased to submit the attached report of the Tax Section of the New York State Bar Association (the "Report"). The Report provides comments on the proposed revisions to the Limitation on Benefits article ("LOB Article") of the U.S. Model Tax Convention (the "Proposed Model").

Generally, the LOB Article provides that a resident of a Contracting State will be entitled to treaty benefits only if it is a "qualified person" or satisfies an active business or derivative benefits test. The changes in the Proposed Model, apart from the addition of the derivative benefits provision, restrict entitlement to treaty benefits as compared with the 2006 Model Treaty. We believe that many of the proposed changes go too far in the direction of restricting access to treaties. In our experience, many taxpayers that are not engaged in treaty shopping or other treaty abuse are prevented from qualifying for treaty benefits even under

the LOB articles of existing treaties, and we are concerned that the changes in the Proposed Model would, if incorporated into a tax treaty, further exacerbate the existing problem. Accordingly, the Report recommends that the Department of the Treasury ("Treasury") narrow the proposals to address clearly articulated cases of treaty shopping or other treaty abuse, but not deny treaty benefits to companies that employ common non-tax motivated structures. We also make a number of other technical comments.

Our specific recommendations are as follows:

1. We recommend that the base erosion test not be added to paragraph 2(d) of the Proposed Model. If, contrary to our recommendation, the base erosion test of paragraph 2(d) is retained, we believe that Treasury should consider not applying it to companies that are wholly or majority owned by a single public company parent.

2. We recommend that the base erosion test not apply to payments of interest to unrelated persons on borrowings that arise from ordinary course capital markets transactions. We further recommend that the exclusion for such interest not be limited to payments to "banks."

3. The Proposed Model treats a payment, even to a qualified person, as a base-eroding payment if the recipient benefits from a "special tax regime" ("STR"). We recommend that if the STR rule in the LOB Article is retained, it should be limited to payments to related persons.

4. We recommend that the exclusion from gross income for "effectively exempt" dividends be removed from the Proposed Model.

5. Proposed paragraph 6(f) defines the term "qualified intermediate owner" (hereafter, "QIO") as an intermediate owner that is a resident of a state that has in effect with the source state a comprehensive tax treaty that includes STR language. We recommend that the STR requirement for QIOs should be eliminated from the Proposed Model at this time, because no existing treaties contain the STR rule.

6. In the context of the derivative benefits provision, we recommend that the "cliff rule" approach to the "as low as" requirement be eliminated in favor of a rule that would apply a blended withholding tax rate.

7. We suggest that Treasury consider not placing a limit on the number of equivalent beneficiaries a company can have, or that it consider increasing the number of equivalent beneficiaries that a tested company can have.

8. With a narrow exception targeted to abuse, we do not support the addition of an "at least as favorable" test where an equivalent beneficiary or QIO seeks to obtain treaty benefits described in Articles 7, 13 and 21. We believe that such a test is too subjective to be applied consistently.

9. We suggest that Treasury consider simplifying and streamlining the various intermediate owner tests set forth in the Model. We question whether the various restrictions upon who can qualify as an intermediate owner or QIO are necessary. In particular, we believe that a subsidiary of a public company that otherwise is a qualified person under paragraph 2(d) should qualify as a "good" intermediate owner. Moreover, we do not think that QIOs should be required to be residents of states, the tax treaties of which confer benefits at least as favorable as those under the treaty being tested.

10. We recommend that an equivalent beneficiary should include a resident of either of the two Contracting States, not only a resident of the State in which the tested company resides.

11. We recommend that the proposed change made to paragraph 3, which would limit the attribution of activities from a connected person to only those cases in which both persons are engaged in the same or complementary lines of business, be eliminated from the Proposed Model.

12. We recommend that the proposed "nexus" condition be removed from paragraph 5 of the Proposed Model, and should be discussed in a Technical Explanation as a relevant factor only.

13. The change to paragraph 1 of the Proposed Model LOB Article, requiring a resident be a qualified person "at the time" when the treaty benefit would be accorded, is unclear. We suggest that a Technical Explanation provide guidance as to the application of the various timing rules in the Proposed Model.

We appreciate your consideration of our recommendations. If you have any questions or comments regarding this report, please feel free to contact us and we will be glad to discuss or assist in any way.

Respectfully submitted,

David R. Sicular
Chair

Enclosure

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