IFA - Comparative Study of the US Conventions with Benelux countries

Speakers: Anja Taferner (EY - LU), Claudine Devillet (Ministry of Finance - BE), Lodewijk P.W. Berger (Jones Day - NL)
Moderator: Thierry Lesage (Arendt & Medernach)

Liège, 12 June 2015

AGENDA

Comparative analysis
- General scope
- Dividends
- Branch tax
- Interest, royalties
- Independent personal services
- Employment income
- Director’s fees
- Entertainers & Sportsmen
- Other income
- LOB
- Elimination of double taxation
- Non-discrimination provision
- Mutual agreement & exchange of information

Practical issues
- US Outbound structures
- US inbound structures
- Corporate inversions
- Domestic rules offering a greater relief
- Access to treaties for investment funds
- Limited Liability Companies
COMPARATIVE ANALYSIS

Treaties between United States and Benelux countries
Comparative analysis – General scope

• Most US tax treaties closely follow the US Model although they are bilaterally negotiated
• US Model was publicised in 1976 and revised several times
• Great similarities between the US Model and the OECD Model but still many differences
• Great influence of US delegates in the development of the OECD Model and in OECD work generally
• On 20 May 2015, US released draft changes to the US Model as a consequence of BEPS work: some proposals are still under consideration under follow-up work on Action 6 (Treaty abuse)
Treaties between United States and Benelux countries
Comparative analysis – General scope

Persons covered (1/4)

• The “saving clause” Art. 1 (BE/Lux)-Art. 24 (NL)
  – U.S. aims at preserving the right to tax its residents and citizens in accordance with its domestic law as if the Convention did not exist
  – Exceptions: a list of provisions with respect to which that principle is not applicable (e.g. provisions on transfer pricing adjustments, relief of double taxation, non-discrimination, MAP, …)
• BE/NL/Lux: the treaty reserves the U.S. right to tax “former citizens” and “former long-term residents”

Persons covered (2/4)

• BEPS Action 6: “saving clause” in the OECD Model to prevent interpretations intended to circumvent the application of CFC rules
  – Provisions of tax treaties may be interpreted as limiting a Contracting State’s right to tax its residents
  – Such interpretations have been rejected in par. 6.1 of the Commentary on Art. 1 of the OECD Model, which deals with a Contracting State’s right to tax partners who are its own residents on their share of the income of a partnership that is treated as a resident of the other Contracting State and in par. 23 on CFCs rules
• BE/Lux/NL observations on the Commentary on Art. 1
Treaties between United States and Benelux countries
Comparative analysis – General scope

Persons covered (3/4)

• The “transparent entities” clause – Art. 1 (BE), Art. 4 (Lux) or Art. 24 (NL)
  – Eliminate technical problems that may prevent investors using transparent entities from claiming treaty benefits, even though they would be subject to tax on the income derived through the entities
  – Prevent the use of transparent entities to claim treaty benefits where the person investing through the entity is not subject to tax on the income in its State of residence
  – Also applies to U.S. LLCs that are treated as partnerships for U.S. tax purposes (NL: examples under § XIV of the Memorandum of understanding)

Persons covered (4/4)

• BEPS Action 2: “transparent entities” clause in the OECD Model
• All situations where, under the domestic law of a Contracting State, the income of an entity or arrangement (or part thereof) is taxed at the level of the persons who have an interest in that entity or arrangement
  – e.g where a State treats a corporation, liable to tax under the laws of its State of residence, as fiscally transparent for the purposes of attributing CFC income to persons having interest in the corporation
• Obligation to provide relief of double taxation under Articles 23 A and 23 B of the OECD Model
  – No further explanation in the draft Commentary
  – Economical double taxation arising from the application of CFC rules?
  – The Partnership Report illustrates how double taxation should be eliminated regardless of a mismatch in entity classification
Treaties between United States and Benelux countries
Comparative analysis – General scope

Taxes covered

• The scope of taxes covered by US treaties is narrower
• Omission of state and local income taxes which may be heavy
• BE: inclusion of par. 1 and 2 of Art. 2 of the OECD Model but with omissions
• Lux/NL: Federal excise taxes imposed on insurance premiums paid to foreign insurers

Resident corporations (1/2)

• Under US domestic law: the place of incorporation (POI) is the criterion for tax residency
• Under BE/Lux/NL domestic laws: the place of management is the key criterion for tax residency

• Under the 3 treaties
  – Where a company is a resident in both States, the competent authorities shall endeavour to settle the question
  – In the absence of agreement, treaty benefits cannot be claimed (limited exceptions with BE/NL)

Treaties between United States and Benelux countries
Comparative analysis – General scope

Resident corporations (2/2)

• BEPS Action 6 : Change of the OECD tie-breaker rule from place of effective management (POEM) to competent authorities agreement taking into consideration relevant factors including POI
  – POEM would give rise to easy tax avoidance (for some countries the main criterion would be the place were the board of directors is meeting)
  – POI also facilitates tax avoidance

Treaties between United States and Benelux countries
Comparative analysis – Dividends

• Article 10 (BE/Lux/NL)
• Nuanced differences, but source-State limitations under BE/Lux/NL Treaties generally comparable:
  – 15% on portfolio dividends
  – 5% on inter-company direct-investment dividends
  – Special rules for Pensions, RICs and REITs
• But: 0% under BE/NL Treaties on inter-company dividends if ≥ 80% of voting stock is held for 12-months, and one of the following requirements is met:

<table>
<thead>
<tr>
<th></th>
<th>US</th>
<th>NL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grandfathering pre-October 1, 1998 structures</td>
<td>-</td>
<td>V</td>
</tr>
<tr>
<td>(indirect) publicly-traded company test</td>
<td>V</td>
<td>V</td>
</tr>
<tr>
<td>Derivative benefits test</td>
<td>V</td>
<td>V</td>
</tr>
<tr>
<td>Combined “ownership-base erosion” and “active trade or business” test</td>
<td>V</td>
<td>-</td>
</tr>
<tr>
<td>Discretionary relief</td>
<td>V</td>
<td>V</td>
</tr>
</tbody>
</table>

• NB: Belgium provides 0% to U.S. corporate shareholders on a non-reciprocal basis ≥ 10% of voting stock is held for 12 months
• Luxembourg similar rule, but ≥25% of voting stock and z-y holding period. Furthermore, active business in Luxembourg required.
Treaties between United States and Benelux countries
Comparative analysis – Branch Profits Tax

- Art 11 NL/Lux, Art 10(10) BE
- US levies a 30% tax on U.S. branch distributions to foreign head office (§884 IRC)
- Tax basis: “Dividend equivalent amounts” (cf. dividends by U.S. subsidiary)
- In accordance with 2006 U.S. Model Convention, BE/Lux/NL Treaties provide for reduced source-State tax equal to rates for inter-company direct-investments dividends, i.e.:
  - 5%, or
  - BE/NL: 0% if conditions for 0% WHT on dividends are met (other than holding conditions)

Treaties between United States and Benelux countries
Comparative analysis – Interest and royalties

- 0%
- Beneficial ownership requirement
- PE exception
- Arm’s length payments
- Specific source rules
- Certain types of interest not covered
  - e.g. Luxembourg profit-dependent interest : dividend rules
  - Belgian interest dependent on receipts, sales, income, profits etc : 15%
- Triangulation clause
Triangulation clause – third country branches

- If Lux exempts PE profits and
- Combined rate of Lux and PE < 50% of Lux rate on income
  - Dividends, interest and royalties: 15% rate
  - Other income taxed based on domestic law of source country (here US)
  - ATB excluded

- Belgium and Netherlands:
  - limited to interest and royalties
  - Rate test:
    - 60% of Be/NL tax (NL 50% until 1998)
  - No exclusion for ATB generally, but for interest in relation to ATB
  - Exclusion for royalties in relation to IP produced or developed by PE

Treaties between United States and Benelux countries
Comparative analysis – Independent personal services

- 2006 U.S. Model Treaty:
  - Professional services and other activities of an independent nature captured by definition of "business" in Article 1(e)
  - Accordingly, either subject to Article 7 (Business Profits) or Article 21 (Other Income)

- BE Treaty: Consistent with 2006 U.S. Model

- Lux & NL Treaty: Specific Article 15
  - Lux: Taxed in residence State, unless attributable to fixed base in host-State. Principles of Business Profits article apply in determining income
  - NL: Taxed in residence State, unless attributable to fixed base in host-State and the activities are not performed in residence-State
Treaties between United States and Benelux countries
Comparative analysis – Employment income

• 2006 U.S. Model Treaty:

  General rule consistent with OECD Model, i.e., employment income may be taxed in State where services are performed, unless

  a. ≤ 183 days presence in source-State,
  b. remuneration is paid by, or on behalf of, an employer outside the source State, or
  c. remuneration is not borne as a deductible expense by a PE in the source-State.

  In order for the remuneration to be exempt from tax in the source State, all three conditions must be satisfied.

• Nuanced differences exist, but Benelux treaties generally consistent.

Treaties between United States and Benelux countries
Comparative analysis – Director’s fees (1/2)

• Director’s fees (1/2)Art. 15 (BE)-Art. 17 (Lux/NL)

• Lux: fees derived by a resident of a contracting State (“C.S”), as a member of the board of directors of a company that is a resident of the other C.S. for services rendered in that other State is taxable in that other State

• NL: idem Lux + fees derived by a “bestuurder” or “commissaris”
  – Dutch companies generally have two “boards”: the Executive Board consists of senior managers who are involved in the day-to-day management and the Supervisory Board is responsible for strategy and oversight supervision

• BE: idem Lux + “gérant/zaakvoerder”

• BE: express exclusion of remuneration for day-to-day functions and application of the Article on Income from Employment; express application of Art. 7 to distributive shares of income in transparent entities
Treaties between United States and Benelux countries
Comparative analysis – Director’s fees (2/2)

- The OECD has started work on the scope of Art. 16 of the Model (suspended because of BEPS)
- BE/NL question the application of that article in relation to dual systems where two separate boards of directors are used to monitor and guide the company
- BE: Art. 15 refers to services rendered as a member of the board of directors; no reference to “a comparable organ” found in Belgian Model
  - QUID? Application to the members of the Executive Committee to which the Board of directors of a Limited liability company may delegate parts of its privileges

Treaties between United States and Benelux countries
Comparative analysis – Entertainers & Sportsmen (1/4)

- Par. 1 (BE/Lux/NL)
  - Applies to income from independent personal services and dependent personal services
  - Income from personal activities as entertainer or sportsman exercised in the other C.S. may be taxed therein
  - Exception where the gross receipts derived by the entertainer or sportsman do not exceed 10,000$ (BE: 20,000$)
  - Par. 1 and its limitation do not apply where the income is taxable in the other C.S. in accordance with the provisions on independent personal services or dependent personal services
  - Application of the Commentary on Art. 17 of the OECD Model (2014): remuneration for rehearsal or training, sponsorship, advertising, …
• Par. 2

– Income for activities of an entertainer (or sportsman) in his capacity as such that accrues to another person may be taxed in the State in which activities are exercised (BE/Lux/NL)

– Exception: not taxable if it is established that the entertainer (or sportsman) or persons related to him participates directly or indirectly in the profits of the person (remuneration, fees, dividends, …) (Lux/NL)

• Par. 2

– Exception: The income is only taxable if the contract pursuant to which the personal activities are performed designates (by name or description) the entertainer or sportsman or allows the other party (or a third party) to designate the entertainer or sportsman who is to perform the personal activities (BE)
Treaties between United States and Benelux countries
Comparative analysis – Entertainers & Sportsmen (4/4)

• NL has abolished the taxation of non-resident entertainers and sportsmen living in a country with which NL has a tax treaty (as of 01/01/2007)
  – The tax revenue is too low and the administrative burden too high to justify source taxation
  – NL favors exclusive taxation of the income in the State of residence
  – NL still wants to counteract tax avoidance in respect of entertainers or sportsmen pretending to live abroad. A certificate of residence is required for tax exemption, giving the State of residence information that income from NL can be expected
  – Important deviation from the OECD Model Treaty

Treaties between United States and Benelux countries
Comparative analysis – Other income (1/3)

• Similar to the US Model (BE/Lux)
  – “income beneficially owned by a resident of a Contracting State”
  – The condition is not met when income is nominally paid to a resident but beneficially owned by a resident of a third State
  – Income received by a nominee on behalf of a resident of the C.S. is entitled to the benefit
  – Interpretation: in accordance with the definition of “beneficial owner” in the OECD Model (2014)? with the domestic law of the C.S. applying the treaty?
Treaties between United States and Benelux countries
Comparative analysis – Other income (2/3)

• Similar to the OECD Model (NL): “items of income of a resident”

• The terms “beneficial owner” was added to address potential difficulties arising from the use of the words “paid to ... a resident” in Articles 10, 11 and 12; it was intended to be interpreted in this context

• Where an item of income is paid to a resident of a C.S. acting in the capacity of agent or nominee or as a conduit, it would be inconsistent with the object and purpose of the Convention to grant relief merely on account of the status of the direct recipient of the income as a resident of the other C.S. since the recipient is not treated as the owner of the income for tax purposes in the State of residence

• OECD work on the definition of “beneficial owner”: no need to include the terms “beneficially owned” in Art. 21

Treaties between United States and Benelux countries
Comparative analysis – Other income (3/3)

• “Business profits” not dealt with under Art. 7?

• Broad scope under Belgian tax law

• All proceeds derived by resident or non-resident companies are deemed business profits irrespective of their nature or origin

• Taxing rights in respect to all items of income subject to Belgian corporate tax that are not dealt with in other distributive articles are dealt with under Art. 7

• Narrow scope under U.S. law
  - e.g. guarantee fees paid within a group are dealt with under “other income” unless the guarantor were engaged in the business of providing guaranties to unrelated parties
Treaties between United States and Benelux countries
Comparative analysis – Limitation on Benefits (LOB) (1/8)

Scope
• Qualified residents :
  – Individuals
  – Contracting states etc.
  – Publicly-traded companies
  – Companies owned by qualified residents /US citizens
  – Companies controlled by publicly traded companies
  – Exempt NPOs

• Companies with active trade or business
• Derivative benefits
• Triangulation provision
• Competent authority relief

Publicly-traded companies
• Luxembourg :
  – Principal class of shares substantially and regularly traded on one or more recognized exchanges
  – At least 6% of average number of shares outstanding during tax year

• Belgium :
  – Also « any disproportionate class of shares »
  – Alternatives : Principal class of shares traded in residence country (or for Be : EEA, for US : NAFTA), or
  – Place of management and control in residence country

• Netherlands :
  – Also « any disproportionate class of shares »
  – Falls outside test if no substantial presence in residence country
Companies controlled by publicly-traded companies

- Luxembourg:
  - Direct or indirect control by publicly-traded companies (as per treaty); and
  - Base erosion test

- Belgium and Netherlands:
  - At least 50% of aggregate vote and value (incl. Disproportionate class of shares)
  - Owned directly or indirectly
  - 5 or fewer publicly-traded companies under the treaty
  - Intermediary companies also resident
  - No base erosion test

Companies owned by qualified residents (“QR”)

- Luxembourg: 2-part test:
  - At least 50% of principal class of shares
  - Ultimately owned by qualified residents under para 2 or US citizens AND
  - Base erosion test

- Netherlands:
  - At least 50% of aggregate voting power and value (including at least 50% of disproportionate shares)
  - Company that fails publicly-traded test due to insufficient presence cannot qualify under this test either

- Belgium:
  - At least 50% of EACH class of shares

- Both Netherlands and Belgium:
  - Clear time reference: At least half of the year
  - Direct or indirect ownership
Non-Profit organisations (NPO/NPOs)

- Luxembourg:
  - NPO that is exempt by virtue of its status
  - > 50% of beneficiaries, members or participants are QRs
- Netherlands and Belgium:
  - 50% ownership requirement only for exempt pension trusts (NL) / pension funds (Be)
  - Owners only need to be residents, not QRs
  - Alternative criterion: sponsoring organization is QR
  - No ownership requirement for NPOs other than pension funds / pension trusts

Active trade or business

- Luxembourg:
  - Active trade or business in residence country
  - Direct or indirect through associated enterprises
  - Income from other state is connected with trade / business and trade must be substantial; or
    - Ratios at least 7.5% and on average at least 10%:
      - Asset values, gross income, payroll
      - Preceding tax year (or in certain situations average over prior years)
  - Income from other state incidental to trade
- Netherlands and Belgium:
  - Definition of "connected person" or associated enterprise
  - Otherwise less detailed but similar application in practice
Derivative benefits

• Luxembourg:
  – Ownership test:
    ◆ 95% of company shares
    ◆ ultimately owned by 7 or fewer residents of NAFTA or EU or US citizens
    ◆ with which the other state has comprehensive tax treaty
  – Base erosion test
  – Rate disparity test

• Belgium and Netherlands:
  – 95% of aggregate voting power and value (and 50% of disproportional class of shares)
  – Directly or indirectly
  – Equivalent beneficiaries also includes EEA (and CH for Belgium)
  – Rate disparity test also considers EU Directives
  – Otherwise less detailed but similar application in practice

Specific headquarter rules

• Only for Netherlands and Belgium

• Conditions
  – Substantial portion of overall supervision and administration of the group (including but not only financing) with independent discretion
  – Group consists in companies engaged in active trade or business in at least 5 countries
  – Income from each of 5 countries (or 5 groupings of countries) at least 10% of gross income of group
  – Countries other than head office country: less than 50% of gross income per country
  – Max 25% of gross income from other country (e.g. NL headquarter: max 25% of income from US)
    ◆ Income must be incidental or connected with active business
  – Same income tax rules as ATB company
Treaties between United States and Benelux countries
Comparative analysis – Elimination of double taxation (1/5)

- Exemption with progression as general method (BE/Lux/NL)
  - BE: general "subject to tax" requirement; "traditional" interpretation "exemption vaut impôt" (although diverging jurisprudence and application)
  - Lux: no "subject to tax" – Art. 23A(1) of the OECD Model
  - NL: "subject to tax" only with respect to business profits and income from independent personal services

Treaties between United States and Benelux countries
Comparative analysis – Elimination of double taxation (2/5)

- Income derived by a resident (company or individual) through an entity which is fiscally transparent in the US but not in BE:
  - Exemption for income treated as dividends under Belgian law
  - Provided the resident has been taxed in the U.S. (proportionally to its participation) on the income out of which income treated as dividends is paid
  - Exemption of income received less costs
  - Object: solve double taxation (diverging interpretations on the obligation to exempt a distribution from a fiscally transparent U.S. LLC under the general exemption method)
  - Does not apply to dividends paid by U.S. RICs and REITs, which are subject as such to U.S. corporate tax
  - Art 1(6) is only applicable in respect to distributive articles
Treaties between United States and Benelux countries
Comparative analysis – Elimination of double taxation (3/5)

• Income derived by a resident through an entity which is fiscally transparent in the US but not in Lux/NL

Treaties between United States and Benelux countries
Comparative analysis – Elimination of double taxation (4/5)

• Treaty participation exemption for dividends
  – As it applies between Belgian companies (BE)
  – Participation of at least 10% directly held since the beginning of the accounting year and the U.S. company is subject to income tax comparable to the Lux corporation tax (Lux)

• Domestic law participation exemption for dividends (NL)
  – Participation of at least 5% of the nominal paid-up capital and one test is met: the sub is not held as a deemed portfolio investment or is subject to reasonable income tax or its assets consist of more than 50% of non-portfolio assets
Treaties between United States and Benelux countries
Comparative analysis – Elimination of double taxation (5/5)

- Tax credit for U.S. WHT levied on dividends not eligible for the participation exemption; limited to the Belgian corporate income tax relating to the dividends (BE autonomous treaty rule); no tax credit for dividends received by individuals (BE)

- Foreign tax credit for US WHT levied on interest or royalties (BE)

- Tax credit for US WHT levied on dividends or interest (Lux)

- Tax credit for US tax on dividends (maximum rate applicable under the applicable rule of Art. 10, directors’ fees or income of artistes and athletes (tax levied) (NL)

Treaties between United States and Benelux countries
Comparative analysis – Non-discrimination provision (1/2)

- Non-discrimination based on nationality
  - Lux/NL: prohibition of “other than or more burdensome” taxation or requirements connected therewith
  - BE: prohibition of “more burdensome” …
  - “in the same circumstances” “in particular with respect to residence” (BE) makes it clear that the residence is a relevant factor in determining whether circumstances are not the same
  - US citizens resident in BE/Lux/NL who are subject to US tax on their worldwide income are not in the same circumstances with respect to US taxation as BE/Lux/NL citizens who are not US residents
Treaties between United States and Benelux countries
Comparative analysis – Non-discrimination provision (2/2)

- OECD PE non-discrimination principle and limitation
  If a sole proprietor who is a resident of BE/Lux/NL has a PE in the U.S., in assessing income tax on
  the profits attributable to the PE, the U.S. is not obligated to allow the personal allowances that the
  sole proprietor would obtain if the PE were operated by a U.S. resident

- OECD non-discrimination principle relating to the deduction of interest, royalties and other
  disbursements paid to a non-resident

- OECD non-discrimination principle relating to resident enterprises controlled by residents of the
  other C.S.

- Specific provisions allowing the application of the U.S. branch tax and covering taxes levied by
  political subdivision and local authorities despite Art. 2

---

Treaties between United States and Benelux countries
Comparative analysis – Mutual Agreement Procedure (1/2)

- Lux/NL: the taxpayer must present his case to the competent authority of his State of residence
  (OECD Model)

- BE: the taxpayer may present his case to the competent authority of either State (change
  recommended under BEPS Action 14)

- Lux/NL: competent authorities may consult for the elimination of double taxation in cases not
  provided in the Convention

- BE: no such possibility but CAs may agree on the same attribution of profits between PEs of
  enterprises of third States

- BE/NL: CAs may agree on the application of domestic law regarding penalties, fines and interest
  in accordance with the purposes of the Convention
Treaties between United States and Benelux countries
Comparative analysis – Mutual Agreement Procedure (2/2)

- **BE:** Mandatory binding arbitration, except if both CAs agree that a specific case is not suitable for arbitration
  
  "baseball" approach as the default rule/no relief through arbitration if the case involves improper use of the Convention or a violation of the Belgian domestic law committed with fraudulent intention

- **Lux:** No arbitration clause

- **NL:** Voluntary binding arbitration but possible mandatory binding arbitration through exchange of diplomatic notes (?)

- Arbitration under BEPS Action 14 (Dispute resolution)

PRACTICAL ISSUES
Hybrid instruments

- PECs treated as debt in Luxembourg
  - No withholding tax under domestic law
- PECs treated as equity in US
  - Deferral and credits
- Treaty entitlement
  - If lending to US: PECs-holder must be "good recipient" for base erosion
- Impact of BEPS actions 2 and 6

Treaties between United States and Benelux countries
Practical issues – US outbound structures

CV/BV

- BV obtains deductions on loans from CV
- CV not taxable in NL
- US treat CV as reverse hybrid, i.e. blocker
  - Deferral until CV distributions
- Impact of BEPS actions 2 and 6
Treaties between United States and Benelux countries
Practical issues – US outbound structures

**Belgian NID**

- Treaty entitlement
  - NID not covered by base erosion test
  - Changes in new US model
- NID not covered by BEPS 2

---

Treaties between United States and Benelux countries
Practical issues – US inbound structures (1/6)

**General**

- In practice, the Limitation on Benefits clauses in the U.S. treaties with BE/Lux/NL often prove an effective measure to avoid the improper use of such U.S. treaties by 3rd country residents
- If any, criticism is directed at perceived “overkill” and hurdles regarding the discretionary relief procedure
- Certain elements of the draft updates to the US Model Treaty released by the U.S. Treasury on May 20, 2015 appear to target US inbound financing through (i) companies that benefit from the notional interest deduction regime (i.e. Belgium) and (ii) companies that benefit from a foreign branch exemption with respect to the income of U.S. finance branches that are not subject to tax in the U.S. (i.e. a Luxembourg Sàrl, with US finance branches)
Treaties between United States and Benelux countries
Practical issues – US inbound structures (2/6)

Base-Erosion and Ownership Test under US/Lux Treaty

- 3rd country investors may benefit from use of an investment entity in a Benelux country if there is sufficient ownership in such vehicle by “qualified persons”

- For instance, if 50% or more of the investors in a Lux Soparfi are qualified persons, the Soparfi may be entitled to benefits under US/Lux treaty under combined base-erosion and ownership test of Article 21(c).

---

Treaties between United States and Benelux countries
Practical issues – US inbound structures (3/6)

Individuals as “equivalent beneficiaries”

Rate Comparison Test under Lux/US Treaty (Art. 34, 4, c) with respect to dividends:

- The tax treaty between the residence state of the ultimate owner(s) must provide “a rate of tax equal to or less than the rate provided under this Convention with respect to the item of income derived from the other State.”

- How measured? If the French individual had invested directly, the tax rate is 15%, but if he had used a French HoldCo the tax rate is 5% (equivalent).
Treaties between United States and Benelux countries
Practical issues – US inbound structures (4/6)

Individuals as “equivalent beneficiaries” (continued)

Exchange of Notes to US/Lux Treaty:

- the following two tax rates must be compared:
  - the rate of tax to which each of the persons described in subparagraph 4 a) would be entitled if they directly held their proportionate share of the shares that gave rise to the dividends; and
  - b) the rate of tax to which the same persons, if they would be residents of the Contracting State of which the recipient is a resident, would be entitled if they directly held their proportionate share of the shares that gave rise to the dividends.

Lux

Individual

Stock

Belgium

HoldCo

0% WHT

Dividend?

USCo

Lux

Individual

Stock

USCo

French

Individual

Stock

Lux

Corp

5% WHT

Dividend

USCo

Failure of Lowest Rate Comparison

Rate Comparison Test under NL/US Treaty with respect to dividends:

- NL/US Treaty provides for both a 0% rate and a 5% rate with respect to direct investment dividends. The Lux/US Treaty only provides for a 5% rate.
- Lux Corp clearly does not qualify as equivalent beneficiary for 0% rate.
- Can NL HoldCo claim 5% rate on the basis that Lux Corp is an equivalent beneficiary for a 5% rate?

Treaties between United States and Benelux countries
Practical issues – US inbound structures (5/6)
Failure of Lowest Rate Comparison (continued)

• An example in Article XVIII of the Memorandum of Understanding to the 2004 Protocol suggests that LuxCo will qualify as an equivalent beneficiary for the 5% rate.

• A similar example is included in the UK/US Treaty, but it is uncertain if this may be extended to other treaties.

Treaties between United States and Benelux countries
Practical issues – Corporate inversions (1/5)

What is meant with “inversions”? A MNE with a U.S. Parent is transformed into a MNE with a non-US Parent under a series of transactions.
Treaties between United States and Benelux countries
Practical issues – Corporate inversions (2/5)

Intended benefits of a U.S. inversion may include:

• Reduced Effective Tax Rates:
  – A US Parent is subject to worldwide tax at 35% (Federal), while the new non-US Parent often
    benefits from a territorial system (e.g., participation exemption)
  – Certain inversion structures result in significant (intercompany) debt owed by the U.S. tax
    group to the new Parent or, a (Luxembourg) finance subsidiary of new Parent

• Repatriation
  – Out-from-under planning
  – Future tax free repatriation of foreign earnings

• Shareholder tax benefits:
  – 0% or reduced WHT on future distributions to shareholders

Treaties between United States and Benelux countries
Practical issues – Corporate inversions (3/5)

• Waves of inversion activity are often followed by US government response. This has lead to
detailed legislation and regulations. In short, transactions may only achieve their intended
benefits if a “Substantial Business Activities” test is satisfied or if certain shareholder ratios are
satisfied.

• Recently, Ireland and the UK are most frequently used as destination countries. Luxembourg and
Belgium are not (often) used.

• The Netherlands is used, but mostly if both (i) the “Substantial Business Activities” test of Section
7874 IRC and (ii) the “Substantial Presence” test of the US/NL Treaty can be met.
Treaties between United States and Benelux countries
Practical issues – Corporate inversions (4/5)

• Unless there is no (significant) trading on a U.S. stock exchange, the "Substantial Presence" test of the US/NL Treaty requires that:

"executive officers and senior management employees exercise day-to-day responsibility for more of the strategic, financial and operational policy decision making for the company (including its direct and indirect subsidiaries) in the Netherlands than in any other state and the staffs conduct more of the day-to-day activities necessary for preparing and making those decisions in the Netherlands than in any other state." Article 26, 8, 3, iii of the US/NL Treaty.

• The Lux treaty does not include a substantial presence test.

Treaties between United States and Benelux countries
Practical issues – Corporate inversions (5/5)

• Dutch NVs are also used in transactions that do not seem to satisfy the "Substantial Business Activities" test of Section 7874 IRC and (ii) the "Substantial Presence" test of the Dutch treaty.

• These transaction either
  – rely on a EU holding company to access the US treaty, or
  – the Dutch NV seeks tax residence in the UK on the basis of the central management and control test under UK law (e.g., Fiat Chrysler, Mylan/Abbott)
Treaties between United States and Benelux countries
Practical issues – Domestic rules offering a greater relief

- Domestic participation exemption rules extended to US residents?
- Unilateral relief to pension funds?

Collective investment vehicles (CIVs): treaty entitlement and application of the LOB clause

- Par. 6.8 to 6.34 of the Commentary on Art. 1 of the OECD Model
- Definition: “funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are established”
CIVs qualifying for the benefits of the Convention in their own rights

- No specific provisions dealing with CIVs as such in BE/Lux/NL treaties with US
- Some CIVs take the form of contractual and fiduciary arrangements
  - BE/Lux Fonds commun de placement; NL closed Fund for Mutual Account
- Some CIVs take the form of a trust
  - U.S. Collective investment trusts
- Many CIVs take the form of a company
  - Lux SICAF/SICAV and NL Exempt Investment Institution: subject to tax but entity exempted as such
  - BE SICAF/SICAV BEVAK/BEVEK: subject to tax but income exempted under conditions
  - NL Fiscal Investment Institution: subject to tax but income tax at 0%
CIVs qualifying for the benefits of the Convention in their own rights: four tier test (cont’d)

- A beneficial owner

A CIV that meets the definition and is a resident under Art. 4 will be considered as the beneficial owner of the dividends and interest that it receives to the extent its managers have the discretionary powers to manage the assets generating the income

- Par. 6.14 of OECD Commentary on Art. 1
- Par. 12.4 of OECD Commentary on Art. 10: typical distribution obligations of CIVs does not prevent a CIV to be the beneficial owner of the income received
- Footnote under par. 12.1 of the OECD Commentary on Art. 10: where the trustees of a discretionary trust do not distribute dividend earned during a given period, they may constitute the beneficial owners

The LOB clause

In many situations a CIV that is a resident and the beneficial owner of the income may not be granted treaty benefits

- The interests in the CIV are not publicly-traded
- The CIV cannot fulfill the combined ownership and base erosion test (difficult to determine whether at least 50% of its interests are held by persons who are resident in a treaty-partner country for more than 183 days, since this would mean that the CIV would need to know every day the tax residence of every underlying investor)

NL: a FFI may prove the number of its Dutch resident shareholders based on the procedure uses by the FFI when claiming a reimbursement of WHT on its foreign dividends and interest under Dutch domestic law (XVI of the MOU)

- The CIV is used for investment purposes and not for the active conduct of a business
Treaties between United States and Benelux countries
Practical issues – Access to treaties for investment funds (6/8)

CIVs qualifying for the benefits of the Convention in their own rights: four tier test (cont’d)

- The LOB clause
  - In many situations a CIV must rely on the discretionary rule to obtain treaty benefits
  - NL/US: A NL company will be granted treaty benefits, under the discretionary rule, if, and only if, it
    - Holds stocks and securities the income of which is not predominantly from US source;
    - Has widely dispersed ownership; and
    - Has substantial staff actively engaged in trades of stock and securities owned by the company
  - To what extent is the discretionary rule effectively applied by the US competent authority to grant treaty benefits ???
  - Article 24.10 US-Lux: Luxembourg CIVs never qualify for treaty benefits

Treaties between United States and Benelux countries
Practical issues – Access to treaties for investment funds (7/8)

CIVs qualifying for the benefits of the Convention in their own rights: four tier test (cont’d)

- The LOB clause - Report on BEPS Action 6 (Treaty Abuse)
  - Subparagraph 2 f) of the LOB clause provides for the inclusion, in the list of “qualified persons”, of a provision dealing especially with CIVs
  - The Commentary includes alternative provisions corresponding to the various approaches included in the 2010 OECD Report concerning the treaty entitlement of CIVs
  - Follow-up work on Action 6: a single preferred approach, taking into account the results of the work on Treaty Relief and Compliance Enhancement (TRACE)
  - However, since there was general support for the conclusions of the CIV Report and since subparagraph 2 f) of the LOB clause reflects these conclusions, no additional changes will be made to the Report on Action 6
  - The CIVs test should be negotiated bilaterally based on the policy considerations favored by each Contracting State
CIVs that do not qualify for the benefits of the Convention in their own right

- A CIV in the form of contractual arrangements, joint owner or transparent entity is not entitled to treaty benefits.
- The investors in the CIV may claim treaty benefits on the income obtained through the CIV under the conditions of the transparent entity clause.
- NL/US mutual agreement on:
  - the application of Art. 24(4) in relation to the income received by NL residents through a closed FGR, and
  - the fact that the fund manager of a closed FGR may claim, on behalf of its investors, the benefits of the Convention on the US source dividends and interest derived by NL residents.

Treaties between United States and Benelux countries
Practical issues – Limited Liability Companies (1/9)

- Under U.S. law, an LLC may combine the liability protection of a corporation with the pass-through tax treatment of partnerships.
- An LLC may elect, under the check-the-box regulations, to be treated as a partnership, or is so treated under the default rules.
- The members are taxed in the U.S. in their share of the partnership profits when the partnership earns the income, regardless of whether and when the income is distributed to the members.
As an LLC has legal personality under the corporate law of the U.S., BE treats the entity as a separate taxpayer for income tax purposes, despite the fact that the LLC is treated as fiscally transparent in the U.S.

The "legal personality" principle has been confirmed in Art. 22(1)(b) in respect to the elimination of double taxation of dividends paid by an hybrid entity to its BE resident partners.

This provision grants relief from double taxation notwithstanding the conflict of qualification resulting from the different treatment of LLCs under BE and US law.

Divergences: Prince de Ligne I and II; Cass. 2/12/2004; Ruling N° 600.252 24/10/2066; BE TA
Treaties between United States and Benelux countries
Practical issues – Limited Liability Companies (4/9)

- LLC is not liable to tax in the U.S. and is not a U.S. resident for the application of the BE/U.S. treaty
- Members are not U.S. residents and cannot benefit from the BE/U.S. treaty
- Members are liable to tax in Switzerland but the royalties are not allocable to them therein (royalties are not treated as income derived by a resident for tax purposes) and are not entitled to benefits under BE/Switzerland treaty
- BE may tax royalties at its domestic rate of 25%

Treaties between United States and Benelux countries
Practical issues – Limited Liability Companies (5/9)

Case: LLC members are residents of BE (3 individuals and company A, each holds an interest of 25%). The LLC distributes income to its members.
Treaties between United States and Benelux countries
Practical issues – Limited Liability Companies (6/9)

- Under U.S. domestic law:
  - The income is treated as income from immovable property in the hands of the members of LLC
  - The subsequent distribution is not a taxable event

- Under BE domestic law:
  - The immovable income allocated to LLC is not a taxable event
  - The subsequent distribution, qualified as “dividend”, is a taxable event
    - normal rules: no participation exemption granted to company A because it is not liable to tax; individuals are taxed at a flat rate on dividends without any foreign credit
    - Art. 22(1)(b): exemption for dividends received by company A and by individuals, provided they have been taxed in the U.S. on the income out of which “dividends” are paid

Treaties between United States and Benelux countries
Practical issues – Limited Liability Companies (7/9)

Case: Co A resident of BE and Co B resident of U.S. pay royalties to LLC for the right to use patents. Member X is U.S. resident and members Y and Z are BE residents (same level of participation). LLC distributes most of the payments received to its members.
**Treaties between United States and Benelux countries**
Practical issues – Limited Liability Companies (8/9)

- X, Y and Z are taxed in the U.S. on their share in the income of LLC (tax rates: 10% to 39.6%)
- WHT (domestic rate of 25%) is due in BE on 2/3 of the gross royalties paid by Co A to LLC (LLC is not a U.S. resident for the application of the Convention; 1/3 of the royalties paid to LLC is treated in U.S. as income of a US resident for tax purposes)
- Dividends received by Y and Z are exempted from income tax in BE
- X is not a taxpayer under BE domestic law
- Only one level of tax is ultimately paid by X, Y and Z

**Treaties between United States and Benelux countries**
Practical issues – Limited Liability Companies (9/9)

- If Y and Z use a U.S. corporation instead of a LLC: no BE WHT on the royalties paid by CoA taxation at the level of the corporation + U.S. WHT of 15% on the dividends paid to Y and Z + BE flat income tax (25% on the net dividend)
- If Y and Z use a BE corporation: taxation at the level of the corporation + BE flat income tax (25% on the gross dividend)
- If Y and Z receive royalties directly: BE income tax at a rate of 25% to 50% (+ local additional tax)