NEW ARTICLE 3 PARAGRAPH 1(l) DEFINITION OF "SPECIAL TAX REGIME":

"l) the term "special tax regime" with respect to an item of income or profit means any legislation, regulation or administrative practice that provides a preferential effective rate of taxation to such income or profit, including through reductions in the tax rate or the tax base. With regard to interest, the term special tax regime includes notional deductions that are allowed with respect to equity. However, the term shall not include any legislation, regulation or administrative practice:

i) the application of which does not disproportionately benefit interest, royalties or other income, or any combination thereof;

ii) that, with regard to royalties, satisfies a substantial activity requirement;

iii) that implements the principles of Article 7 (Business Profits) or Article 9 (Associated Enterprises);

iv) that applies principally to persons that exclusively promote religious, charitable, scientific, artistic, cultural or educational activities;

v) that applies principally to persons substantially all of the activity of which is to provide or administer pension or retirement benefits;

vi) that facilitates investment in entities that are marketed primarily to retail investors, are widely-held, that hold real property (immovable property), a diversified portfolio of securities, or any combination thereof, and that are subject to investor-protection regulation in the Contracting State in which the investment entity is established; or

vii) that the Contracting States have agreed shall not constitute a special tax regime because it does not result in a low effective rate of taxation;"

RELATED PROVISIONS FOR NEW MODEL PROTOCOL:

"2. With reference to subparagraph (l) of paragraph 1 of Article 3 (General Definitions):

The term "special tax regime" shall include:

(a) in the case of _______:

(i) list relevant specific legislation, regulations and/or administrative practices in other Contracting State.

3. With reference to clause (vii) of subparagraph (l) of paragraph 1 of Article 3 (General Definitions):

The term “special tax regime” shall not include:

(a) in the case of the United States:

(i) list any relevant specific legislation, regulations and/or administrative practices in the United States; and

(b) in the case of _______:

(i) list relevant specific legislation, regulations and/or administrative practices in other Contracting State.”

TECHNICAL EXPLANATION FOR DEFINITION OF “SPECIAL TAX REGIME”:

Subparagraph 1(l) defines the term “special tax regime” with respect to an item of income. The term is used in Articles 11 (Interest), 12 (Royalties), and 21 (Other Income), each of which denies treaty benefits to items of income if the resident of the other Contracting State (the residence State) beneficially owning the interest, royalties, or other income, is related to the payor of such income, and benefits from a special tax regime in its residence State with respect to the particular category of income. This rule allows the Contracting State in which the item of income arises to retain its right to tax the income under its domestic law if the resident benefits from a regime in the residence State with respect to a category of income that includes the item of income that results in low or no taxation. The term “special tax regime” also is used in Article 22 (Limitation on Benefits) for the purposes of the so-called “derivative benefits” rule in paragraph 4 of that Article.

The application of the term “special tax regime” in Articles 11, 12 and 21 is consistent with the tax policy considerations that are relevant to the decision to enter into a tax treaty, or to amend an existing tax treaty, as articulated by the Commentary to the OECD Model, as amended by the Base Erosion and Profits Shifting initiative. In particular, paragraph 15.2 of the introduction of the OECD Model now provides:

> “Since a main objective of tax treaties is the avoidance of double taxation in order to reduce tax obstacles to cross-border services, trade and investment, the existence of risks of double taxation resulting from the interaction of the tax systems of the two States involved will be the primary tax policy concern. Such risks of double taxation will generally be more important where there is a significant level of existing or projected cross-border trade and investment between two States. Most of the provisions of tax treaties seek to alleviate double taxation by allocating taxing rights between two States and it is assumed that where a State accepts treaty provisions that restrict its right to tax elements of income, it generally does so on the understanding that these elements of income are taxable in the other State. Where a State levies no or low income taxes, other States should consider whether there are risks of double taxation that would justify, by themselves, a tax treaty. States should also consider whether there are elements of another State’s tax system that could increase the risk of non-taxation, which may include tax advantages that are ring-fenced from the domestic economy.”

The term "special tax regime" means any legislation, regulation, or administrative practice that provides a preferential effective rate of taxation to interest, royalties or other income, including through reductions in the tax rate or tax base. In the case of interest, the term includes any legislation, regulation, or administrative practice, whether or not generally available, that provides notional deductions with respect to equity. For purposes of this definition, an administrative practice includes a ruling practice.

For example, if a taxpayer obtains a ruling providing that its foreign source interest income will be subject to a low rate of taxation in the residence State, and that rate is lower than the rate that generally would apply to foreign source interest income received by residents of that State, the administrative practice under which the ruling is obtained is a special tax regime.

Paragraph 2 of the Protocol provides a list of the legislation, regulations, and administrative practices existing in the other Contracting State at the time of the signature of the Convention that the Contracting States agree are "special tax regimes" within the meaning of paragraph 1(l) of Article 3.

A special tax regime does not, however, include any legislation, regulation, or administrative practice that meets at least one of the following seven criteria.

Clause (i) of subparagraph (1)(l) provides that any legislation, regulation, or administrative practice whose application does not disproportionately benefit interest, royalties, or other income, or any combination thereof, as the case may be, is not a special tax regime. To satisfy this criterion, the legislation, regulation, or administrative practice must be generally applicable to income and available across industries. Notwithstanding the foregoing, the provision of notional deductions with respect to equity will always be considered to disproportionately benefit interest. Examples of generally applicable provisions that would not be considered special tax regimes include regimes permitting standard deductions, accelerated depreciation, corporate consolidation, dividends received deductions, loss carryovers, and foreign tax credits. This exception also generally applies to the exemption of income attributable to permanent establishments in other states. However, the exception will not apply if the residence State administers such exception in a manner that is reasonably expected to disproportionately benefit interest, royalties or other income by, for example, treating such income as attributable to a foreign permanent establishment in circumstances in which the state in which the permanent establishment is situated would not be expected to tax the income.

Clause (ii) of subparagraph (1)(l) provides an exception with regard to royalties for any legislation, regulation, or administrative practice that is designed to incentivize, and in fact requires, substantial activities that are not of a mobile nature to be conducted in the residence State. Thus, if the residence State enacts legislation that provides preferential tax treatment for payments received with respect to intellectual property, such legislation is not a special tax regime if the tax benefit provided by the regime is limited (including by a proportionality rule) to income that is attributable to the activities of developing the intellectual property that occurred in the residence State. [It is anticipated that the substantial activity exception would be interpreted consistent with any standards promulgated by the Forum on Harmful Tax Practices.] Another example of a regime that is within the exception of clause (ii) is a special economic zone that is intended to stimulate, and in fact requires, investment in manufacturing. In the case of the United States, for example, this exception would apply to Code sections 41 and 199, which are available only with respect to research and production activities, respectively, performed in the United States.

Clause (iii) of subparagraph (1)(l) provides that any legislation, regulation, or administrative practice that implements the principles of Article 7 (Business Profits) or Article 9 (Associated Enterprises) is not a special tax regime. Thus, if a taxpayer obtains an advance pricing agreement (APA) under Article 25 (Mutual Agreement Procedure) or, in the case of the United States, a unilateral APA under Revenue Procedure 2015-__ (or subsequent guidance), the administrative practice under which the APA is obtained is not a special tax regime. However, a special tax regime may include any legislation, regulation, or administrative practice, including a ruling practice, that is inconsistent with the arm's-length principle or the rules for attribution of profits to a permanent establishment described in the report of the OECD "2010 Report on the Attribution of Profits to Permanent Establishments."

Clause (iv) of subparagraph (1)(l) provides that any legislation, regulation, or administrative practice that applies principally to persons that are maintained exclusively for religious, charitable, scientific, artistic, cultural, or educational purposes is not a special tax regime. This exception applies, for example, to charitable organizations that are established under Code section 501(c)(3). The status of these organizations as residents of a Contracting State for purposes of the Convention is clarified in subparagraph 2(b) of Article 4 (Resident).

Clause (v) of subparagraph (1)(l) provides that any legislation, regulation, or administrative practice that applies principally to regulated entities substantially all of the activities of which is to administer or provide pension or retirement benefits is not a special tax regime. In the case of the United States, for example, this exception applies to an entity described in Code section 401(a). The status of these persons as "pension funds" and as residents of a Contracting State are clarified in subparagraph 1(k) of Article 3 (General Definitions) and subparagraph 2(a) of Article 4 (Resident), respectively.

Clause (vi) of subparagraph (1)(l) provides that any legislation, regulation, or administrative practice that facilitates collective investment is not a special tax regime. This exception is intended to apply to collective investment vehicles that are marketed primarily to retail investors, widely-held, hold real property (immovable property), a diversified portfolio of securities, or a combination thereof, and are subject to investor-protection regulation in the Contracting State in which they are organized. This exception applies, for example, to regulated investment companies that are established under Code section 851. Although legislation, regulations, or administrative practices that are designed to facilitate collective investment are not considered to be special tax regimes, persons who are subject to tax under any such legislation, regulations, or administrative practices must nevertheless satisfy all relevant requirements set forth in the Convention in order to obtain benefits, including the requirements of Articles 4 (Resident) and 22 (Limitation on Benefits).

The exception from the definition of special tax regime in clause (vi) also applies, in the case of the United States, to real estate investment trusts (REITs) that satisfy the requirements of Code sections 856 through 859. Although REITs are not required to hold a diversified portfolio of real estate investments, they are designed to facilitate collective investment and are subject to investor-protection regulation.

Clause (vii) of subparagraph (1)(l) provides that, notwithstanding the prior provisions of the subparagraph, the Contracting States may agree that any legislation, regulation or administrative practice does not constitute a special tax regime because it does not result in a low or no effective rate of taxation. Paragraph 3 of the Protocol enumerates those regimes that, at the time of the signing of the Convention, the Contracting States have agreed are not considered special tax regimes for purposes of the Convention because they do not result in low or no effective rates of taxation. The Contracting States shall endeavor to determine if any regimes that come into existence after the date of signature of the Protocol shall not constitute a special tax regime pursuant to clause (vii). For this purpose, it is anticipated that any legislation, regulation, or administrative practice that results in an effective rate of taxation of at least 15 percent would not be considered to result in a low or no effective rate of taxation. Any subsequent agreements between the Contracting States that a regime satisfies the requirements of clause (vii) must be reflected in an exchange of diplomatic notes between the governments of the Contracting States before the exception shall apply.

As of the date of signature of the Convention, no U.S. legislation, regulations, or administrative practices that apply with respect to interest, royalty or other income would satisfy the definition of special tax regime.

NEW ARTICLE 11 (INTEREST) PARAGRAPH 2(c):

> "c) interest arising in a Contracting State and beneficially owned by a resident of the other Contracting State that is related to the payor of the interest may be taxed in the first-mentioned Contracting State in accordance with domestic law if such resident is subject to a special tax regime with respect to interest in its Contracting State of residence at any time during the taxable period in which the interest is paid;"

TECHNICAL EXPLANATION:

Subparagraph 2(c) provides an exception to the rule in paragraph 1 providing for exclusive residence taxation of interest in cases where the beneficial owner of the interest is related to the payor of the interest and benefits from a special tax regime with respect to interest in its State of residence at any time during the taxable year in which the interest is paid. In such cases, the interest will be subject to tax in the State in which it arises according to that State's domestic law. The term "special tax regime" is defined in paragraph 1(l) of Article 3 (General Definitions). As of the date of signature of the Convention, no U.S. legislation, regulations, or administrative practices satisfy the definition of special tax regime. Paragraph 2 of the Protocol provides a list of the legislation, regulations, and administrative practices existing in the other Contracting State at the time of the signature of the Convention that the Contracting States agree are special tax regimes.

NEW ARTICLE 12 (ROYALTIES) PARAGRAPH 5(a):

> “a) royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State that is related to the payor of the royalty may be taxed in the first-mentioned Contracting State in accordance with domestic law if such resident is subject to a special tax regime with respect to royalties in its Contracting State of residence at any time during the taxable period in which the royalties are paid;”

TECHNICAL EXPLANATION:

Subparagraph 5(a) provides an exception to the rule in paragraph 1 providing for exclusive residence taxation of royalties in cases where the beneficial owner of the royalties is related to the payor of the royalties and benefits from a special tax regime with respect to royalties in its State of residence at any time during the taxable year in which the royalties are paid. In such cases, the royalties will be subject to tax in the State in which they arise according to that State’s domestic law. The term “special tax regime” is defined in paragraph 1(l) of Article 3 (General Definitions). As of the date of signature of the Convention, no U.S. legislation, regulations, or administrative practices satisfy the definition of special tax regime. Paragraph 2 of the Protocol provides a list of the legislation, regulations and administrative practices existing in the other Contracting State at the time of the signature of the Convention that the Contracting States agree are special tax regimes.

NEW ARTICLE 21 (OTHER INCOME) PARAGRAPH 3(a):

> “a) other income arising in a Contracting State and beneficially owned by a resident of the other Contracting State that is related to the payor of the income may be taxed in the first-mentioned Contracting State in accordance with domestic law if such resident is subject to a special tax regime with respect to other income in its Contracting State of residence at any time during the taxable period in which the other income is paid;”

TECHNICAL EXPLANATION:

Subparagraph 3(a) provides an exception to the rule of paragraph 1 providing for exclusive residence taxation of other income in cases where the beneficial owner of the other income is related to the payor of the other income and benefits from a special tax regime in its State of residence at any time during the taxable year in which the other income is paid. In such cases, the other income will be subject to tax in the State in which it arises according to that State’s domestic law. The term “special tax regime” is defined in paragraph 1(1) of Article 3 (General Definitions). As of the date of signature of the Convention, no U.S. legislation, regulations, or administrative practices satisfy the definition of special tax regime. Paragraph 2 of the Protocol provides a list of the legislation, regulations and administrative practices existing in the other Contracting State at the time of the signature of the Convention that the Contracting States agree are special tax regimes.