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Kill-Switches in the U.S. Model Tax Treaty

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KILL-SWITCHES IN THE U.S. MODEL TAX TREATY

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INTRODUCTION

The latest U.S. Model Income Tax Convention released in February 2016 contains an unusual addition: mechanisms

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for the parties to unilaterally override the negotiated treaty rates in specified circumstances. Previewed last year in proposed form—a first for the U.S. Treasury[1]—these mechanisms work as kill-switches, partially terminating the treaty as to one or both treaty partners. The idea is to forestall a more problematic outcome, such as an enduring breach of one of the parties' expectations, or the opposite, a complete termination of all the treaty terms in the face of such a breach.

These kill-switch provisions are not yet in operation via negotiated treaties, and the terms will no doubt evolve when put in practice. Examining the current language, however, will help explain the motivations and precedent for introducing these measures and how they might represent a new vision for tax treaties. That is the aim of this article.

Part I outlines the context for the proposed introduction of kill-switches in the U.S. Model Income Tax Convention. Part II explores the international precedents for such provisions and compares them to the proposed language. Part III analyzes the political and legal implications of incorporating these provisions into general treaty practice. The article concludes that, besides altering key procedural formalities typically involved in treaty formation, kill-switch clauses set the stage for a fundamental shift in the scope and purpose of tax treaties going forward.

I. CONTEXT AND IMPETUS FOR REFORM

Most observers of the international tax order point to the model tax conventions and guidance of the Organisation for Economic Co-operation and Development (OECD) and the United Nations as two transnational sources of global tax norms.[2] The

1. SELECT DRAFT PROVISIONS OF THE U.S. MODEL INCOME TAX CONVENTION (U.S. DEP'T OF THE TREASURY 2015) [hereinafter SELECT DRAFT PROVISIONS], https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-Special-Tax-Regimes-5-20-2015.pdf; SELECT DRAFT PROVISIONS OF THE U.S. MODEL INCOME TAX CONVENTION: NEW ARTICLE 28 (U.S. DEP'T OF THE TREASURY 2015) [hereinafter DRAFT PROVISIONS: ARTICLE 28], https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-Subsequent-Changes-in-Law-5-20-2015.pdf.

2. *See* MODEL CONVENTION WITH RESPECT TO TAXES ON INCOME AND ON CAPITAL (ORG. FOR ECON. CO-OPERATION & DEV. 2014); U.N. MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPED AND DEVELOPING COUNTRIES (U.N. DEP'T OF ECON. & SOCIAL AFFAIRS 2011); *see also* REUVEN S. AVI-YONAH, INTERNATIONAL TAX AS INTERNATIONAL LAW: AN ANALYSIS OF THE INTERNATIONAL TAX REGIME (2007); HUGH J. AULT & BRIAN J. ARNOLD,

United States, however, has long had its own Model Income Tax Convention, the newest version of which is formally referred to as the United States Model Income Tax Convention of February 17, 2016 ("U.S. Model").[3] The U.S. Model is structurally very similar to the OECD and U.N. Models, yet stands alone as a conveyer of certain tax policy standards specific to the United States.[4]

The U.S. Treasury periodically updates the U.S. Model, generally to reflect policy changes that have been introduced into bilateral treaties on a piecemeal basis.[5] The immediate predecessor to the current U.S. Model was the United States Model Income Tax Convention of November 23, 2006 ("2006 U.S. Model").[6] The U.S. Model is heavily influential given the importance of the United States in global markets; thus, the addition of kill-switch provisions may well impact the treaty policies of other nations.

The U.S. Treasury's decision to release proposed updates in draft form and invite public comment is unusual. Rather than reflect a landscape that has already evolved, it seems to signal a coming change. This Part explores the context for a possible policy shift by briefly outlining the U.S. Treasury's reasons for making the proposals, and then examines the two kill-switch provisions in their proposed and final forms.

A. The Problem to be Solved

The timing of the proposed changes to the U.S. Model appear to be designed as a way to globalize U.S. policy preferences in

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COMPARATIVE INCOME TAXATION: A STRUCTURAL ANALYSIS 347–350 (2d ed. 2004).

3. U.S. MODEL INCOME TAX CONVENTION (U.S. DEP'T OF THE TREASURY 2016) [hereinafter 2016 U.S. MODEL].

4. For example, the United States only provides for foreign tax credits as a method for relieving double taxation, while the OECD provides for both credit and exemption methods. For a discussion, see Allison Christians, *Tax Treaties for Investment and Aid to Sub-Saharan Africa: A Case Study*, 71 BROOK. L. REV. 639 (2005).

5. New models also address contemporary exigencies of business and investment, which may have impacted the treaty relationship. *See, e.g.*, Walter F. O'Connor, *A Comparative Analysis of the 1981 and 1996 U.S. Model Income Tax Treaties*, 24 INT'L TAX J., no. 4, 1998, at 9 ("Renovation of tax treaties has generally been a response to new developments in the business world.").

6. U.S. MODEL INCOME TAX CONVENTION (U.S. DEP'T OF THE TREASURY 2006) [hereinafter 2006 U.S. MODEL].

the context of the OECD's ongoing project to counter "base erosion and profit shifting" (BEPS).[7] The BEPS project timeline included the release of action plans by the end of 2015. The OECD duly released fifteen action plans laying out minimum standards, recommendations, and best practices agreed to by its members and non-OECD "BEPS Associate" countries.[8] By releasing proposed model treaty provisions in the fall of 2015, the United States ensured that its policy plans would be reflected in these OECD documents.

The U.S. Model proposals purport to target so-called "double non-taxation," which loosely refers to a situation (generally created by treaty) whereby income normally subject to tax in at least one jurisdiction ends up being subject to tax in neither (and possibly nowhere at all at the entity level). The general issue is that taxpayers combine reduced source-based withholding rates granted in a treaty with favorable domestic tax regimes to eliminate taxation at the entity level by both (or multiple) countries. This issue has been a driving force of the BEPS initiative and is reflected in many of the action plans, with special attention in those directed at countering treaty abuse.[9]

In the draft Technical Explanations accompanying the proposed provisions, the U.S. Treasury explains that the existing U.S. treaty network can at times operate to "facilitate" BEPS, and the proposed changes are a direct attempt to combat

7. *See, e.g.*, Laura Davison & Kevin A. Bell, *U.S. Proposed Changes to Model Tax Treaty Intended to Influence BEPS Discussions*, 98 DAILY TAX REP. G-6 (2015); *see also* J.P. Finet, *ABA Meeting: U.S. Model Tax Treaty Proposals Were Meant to Influence* OECD, 79 TAX NOTES INT'L 1103 (2015) (reporting that Quyen Huynh, U.S. Treasury associate international tax counsel, stated that "the L[imitation] O[n] B[enefits] approach is the U.S.'s preferred method for addressing treaty abuse and that [the U.S.] Treasury wanted to influence some of the discussions at the OECD with the release of the proposed revisions to the U.S. model treaty.").

8. For an overview of the fifteen action plans, see ORG. FOR ECON. CO-OPERATION & DEV. [OECD], EXECUTIVE SUMMARIES: 2015 FINAL REPORT (2015), https://www.oecd.org/ctp/beps-reports-2015-executive-summaries.pdf.

9. ORG. FOR ECON. CO-OPERATION & DEV. [OECD], PREVENTING THE GRANTING OF TREATY BENEFITS IN INAPPROPRIATE CIRCUMSTANCES, ACTION 6 - 2015 FINAL REPORT 9 (2015) [hereinafter ACTION 6 FINAL REPORT] ("Taxpayers engaged in treaty shopping and other treaty abuse strategies undermine tax sovereignty by claiming treaty benefits in situations where these benefits were not intended to be granted, thereby depriving countries of tax revenues.").

abuses.[10] Of course, using treaties to accomplish double non-taxation is hardly a new phenomenon, and this is not the first time the United States has released Model Treaty language designed to address it. Every U.S. Model Treaty has included various anti-abuse rules, and U.S. lawmakers have long deliberated over the proper scope of safeguards.[11]

The proposed provisions accordingly addressed five issue areas: (i) exempt permanent establishments,[12] (ii) "special tax regimes,"[13] (iii) subsequent changes in law,[14] (iv) revisions to the Limitation on Benefits (LOB) provisions,[15] and (v) "expatriated entities."[16] The provisions interact in various ways.

The focus of this article is on proposals (ii) and (iii): special tax regimes and subsequent-law changes. Each proposal introduces a kill-switch for treaty withholding rates, in effect overriding or partially terminating the treaty in the event a treaty partner adopts certain provisions in its domestic law. These provisions have already been incorporated as U.S.-initiated proposals in the OECD's Action Plan 6: 2015 Final Report, "Preventing the

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10. Technical Explanations are interpretive documents developed by the U.S. Treasury to explain tax treaty provisions. For a list of recent treaties and explanations, see *Resource Center – Treaties and TIEAs*, TREASURY.GOV, https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/treaties.aspx (last visited July 23, 2016).

11. For an early assessment based on the first U.S. Model Tax Convention, see Robert R. Oliva, *The Treasury's Twenty Year Battle with Treaty Shopping: Article 16 of the 1977 United States Model Treaty*, 14 GA. J. INT'L & COMP. L. 293 (1984).

12. SELECT DRAFT PROVISIONS OF THE U.S. MODEL INCOME TAX CONVENTION: NEW ARTICLE 1, PARA. 7 (U.S. DEP'T OF THE TREASURY 2015), https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-Exempt-Permanent-Establishments-5-20-2015.pdf.

13. SELECT DRAFT PROVISIONS, *supra* note 1, art. 3, para 1(l).

14. DRAFT PROVISIONS: ARTICLE 28, *supra* note 1.

15. SELECT DRAFT PROVISIONS OF THE U.S. MODEL INCOME TAX CONVENTION: NEW ARTICLE 22 (U.S. DEP'T OF THE TREASURY 2015) [hereinafter DRAFT PROVISIONS: ARTICLE 22], https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-Limitation-on-Benefits-5-20-2015.pdf. The provisions impact different categories of income and cover distinct situations, as discussed more fully below.

16. SELECT DRAFT PROVISIONS OF THE U.S. MODEL INCOME TAX CONVENTION (2015), https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-Payments-by-Expatriated-Entities-5-20-2015.pdf (containing articles 10, 11, 21, and 21).

Granting of Treaty Benefits in Inappropriate Circumstances."[17] This means that the inclusion of such provisions is now on the table for inclusion in a multilateral tax instrument to be coordinated by the OECD. Each provision is discussed in turn.

B. Special Tax Regimes

A special tax regime, under the proposed definition, is a prescribed set of circumstances that entitles an income recipient to a "preferential" effective tax rate in the person's home jurisdiction.[18] The treaty then denies certain benefits where a person makes a specified payment to a "connected person" who is eligible for a special tax regime.[19]

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17. ACTION 6 FINAL REPORT, *supra* note 9, at 96 ("A State that has . . . BEPS concerns with respect to certain features of the domestic law of a prospective treaty partner or with respect to changes that might be made after the conclusion of a tax treaty may want to protect its tax base against such risks and may therefore find it useful to include in its treaties provisions that would restrict treaty benefits with respect to taxpayers that benefit from certain preferential tax rules or with respect to certain drastic changes that could be made to a country's domestic law after the conclusion of a treaty. [The included] proposals seek to achieve this objective.").

18. SELECT DRAFT PROVISIONS, *supra* note 1, art. 3, para 1(l), at 3 ("[A]ny 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," as modified by listed inclusions and exclusions.).

19. In proposed form, consistent with prior treaty language, the U.S. Treasury used the term "related person." In the U.S. Model, the term has been replaced by "connected person" both in the context of the special tax regime provisions and elsewhere. Article 3 explains that:

> [T]wo persons shall be "connected persons" if one owns, directly or indirectly, at least 50 percent of the beneficial interest in the other (or, in the case of a company, at least 50 percent of the aggregate vote and value of the company's shares) or another person owns, directly or indirectly, at least 50 percent of the beneficial interest (or, in the case of a company, at least 50 percent of the aggregate vote and value of the company's shares) in each person. In any case, a person shall be connected to another if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same person or persons.

2016 U.S. MODEL, *supra* note 3, art. 3, para. 1(m).

For example, imagine that TreatyCo is a company that is a tax resident of a treaty country. As such, TreatyCo is normally eligible for the treaty rate for income earned from U.S. sources. Taking the stated rate in the U.S. Model, for example, TreatyCo would generally pay 15 percent in tax on interest it received from a U.S. borrower[20] and no U.S. tax on a royalty received from a U.S. source;[21] it would also pay no U.S. tax on any U.S. source income not otherwise dealt with in the treaty.[22] TreatyCo, however, would be denied these rates and subjected instead to the regular U.S. rates (generally 30 percent) if TreatyCo is related to the payor of the income item and the income item is subject to a tax that meets the definition of a special tax regime.

In proposed form, all that appeared to be needed for a special tax regime to exist was a "reduction" in the tax rate or tax base as to specified types of income, which could occur pursuant to a law or regulation or by administrative practice, such as a private letter ruling. By way of example, the U.S. Treasury identified a special tax regime where a residence state gives a taxpayer a ruling that lowers the tax rate on its foreign-source interest income relative to the rate that residents of that state would generally pay.[23] The terms of the definition and example implies that the level of reduction would be irrelevant, making it likely that clarity on this issue will be provided in the form of treaty-based guidance.[24]

In proposed form, the new U.S. Model and the multilateral treaty envisioned under BEPS Action Plan 15 (assuming the U.S. proposals are adopted by the OECD)[25] would have denied

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20. *Id.* art. 11.

21. *Id.* art. 13.

22. *Id.* art. 21.

23. SELECT DRAFT PROVISIONS, *supra* note 1, art. 3, at 3.

24. The U.S. Treasury typically issues administrative guidance regarding the U.S. Model and its bilateral tax treaties in the form of Technical Explanations, which provide explanations as to the meaning and purpose of the various provisions. *See, e.g.*, TECHNICAL EXPLANATION ACCOMPANYING THE UNITED STATES MODEL INCOME TAX CONVENTION OF NOV. 15, 2006 (U.S. DEP'T OF THE TREASURY 2006), https://www.treasury.gov/press-center/press-releases/Documents/hp16802.pdf. It should be noted, however, that Technical Explanations are regulatory guidance rather than bilateral instruments, and they are not always adhered to by U.S. courts.

25. *See* ACTION 6 FINAL REPORT, *supra* note 9, at 96 ("When these new versions of the United States proposals were discussed, it was agreed that they should be further examined once finalised by the United States in the light of the comments that will be received on them. For that reason, the proposals

the treaty rate on interest, royalties, and "other income" to any recipient entitled to a special tax regime where the recipient is related to the payor of the income.[26] The treaty withholding rates were to be preserved for other taxpayers. Thus, Articles 11, 12, and 21 were to include the following new paragraphs, respectively:

> New Article 11(2)(c) (Interest): 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;[27]
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> New Article 12(5)(a) (Royalties): 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;[28]
>
> New Article 21(3)(a) (Other Income): 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.[29]

Special tax regimes in existence at the time a treaty was being negotiated were to be listed in the Article 3 definitions section of

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below will need to be reviewed and, if necessary, finalised in the first part of 2016, which will allow any decision reached on these proposals to be taken into account as part of the negotiation of the multilateral instrument that will implement the results of the work on treaty issues mandated by the BEPS Action Plan.").

26. SELECT DRAFT PROVISIONS, *supra* note 1, art. 11(2)(c) (Interest), 12(5)(a) (Royalties), 21(3)(a) (Other Income).

27. *Id.* art. 11(2)(c).

28. *Id.* art. 12(5)(a).

29. *Id.*

the treaty, together with regimes that each party agreed were not special tax regimes.[30]

The U.S. Treasury's position is that no current provisions in U.S. law constitute a special tax regime. U.S. Treasury officials identified a few targets for treatment as special tax regimes, including Luxembourg convertible preferred equity certificates and notional interest deductions for equity in Belgium and Luxembourg.[31] Notional interest deductions, however, are not treated as a special tax regime in the U.S. Model. Instead, they are separately addressed in revised Article 11(2)(e), which states that the treaty simply will not apply to payments of interest to a "connected person" that benefits from notional deductions in the jurisdiction in which the beneficial owner of the interest income is resident.[32]

In the final version adopted in the U.S. Model, the broad language in Article 21 (Other Income) is now limited to guarantee fees, but the provisions in Articles 11 and 12 are substantially the same as proposed:

> Article 11(c) (Interest): interest arising in a Contracting State and beneficially owned by a resident of the other Contracting State that is a connected person with respect to the payor of the interest may be taxed in the first-mentioned Contracting State in accordance with domestic law if such resident benefits from a special tax regime with respect to such interest in its Contracting State of residence;[33]
>
> Article 12(2)(a) (Royalties): a royalty arising in a Contracting State and beneficially owned by a resident of the other Contracting State that is a connected person with respect to the payor of the royalty may be taxed in the first-mentioned Contracting State in accordance with domestic law if such resident

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30. *Id.* art. 3, at 1–2 (Related Provisions for New Model Protocol).

31. Lee A. Sheppard, *Who's Willing to Sign U.S. Treasury's New Treaty Provisions?*, 148 TAX NOTES INT'L 192 (2015) (quoting Danielle Rolfes, U.S. Treasury International Tax Counsel).

32. 2016 U.S. MODEL, *supra* note 3, art. 11(2)(e). Notional interest deductions are deductions allowed for payments made in respect of equity rather than debt. In effect, notional interest deductions treat certain dividends as interest for tax purposes. Some countries have introduced these deductions in order to align the tax treatment of companies financed by equity with that of those financed by debt. The effect is to significantly lower the effective rate of tax on profits in such countries, especially for companies with equity-intensive activities such as intellectual property-driven enterprises.

33. 2016 U.S. MODEL, *supra* note 3, art. 11(c).

> benefits from a special tax regime with respect to the royalty in its Contracting State of residence;[34] and
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> Article 21(2)(a) (Other Income): a guarantee fee arising in a Contracting State and characterized as other income by that Contracting State and beneficially owned by a resident of the other Contracting State that is a connected person with respect to the payor of the guarantee fee may be taxed in the first-mentioned Contracting State in accordance with domestic law if such resident benefits from a special tax regime with respect to the guarantee fee in its Contracting State of residence.[35]

The definition of special tax regime has become more detailed and narrower in scope; "related" parties are now "connected" parties, and some new procedural provisions have been incorporated.[36] A special tax regime is now defined by reference to a specified list of six conditions, all of which must be met in order for the regime to be a specified tax regime. The treaty then denies certain treaty benefits to income recipients who are connected to the payor and who are eligible for such a regime.

First, the regime must provide a reduction in the general rate or base structure for interest, royalties, and guarantee fees, or for the income earned by companies not engaged in an active trade or business.[37] For interest, royalties, and guarantee fees, whether the regime is preferential depends on the country's general rate or the general composition of the tax base for income from sales of goods or services.[38]

For example, if a country imposes a rate of 14.5 percent on a certain type of interest when the general rate on income from the sale of goods is 15 percent, the rate would be preferential. A drop in the general rate to 14.5 percent would reverse the prop-

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34. *Id.* art. 12(2)(a).

35. *Id.* art. 21(2)(a).

36. *Id.* art. 3(1)(l).

37. As discussed above, the targeted income items in the proposed provision included "other income," a defined term in Article 21 that includes guarantee fees. Thus the final language narrows the application of the special tax regime characterization.

38. 2016 U.S. MODEL, *supra* note 3, art. 3(1)(l)(i)(A), (B). Distinct from the proposed provisions, "notional interest deductions" are not treated as a special tax regime in the U.S. Model. Instead, Article 11(e) states that the treaty will not apply to payments of interest to a "connected person" that benefits from notional deductions in the jurisdiction in which the beneficial owner of the interest income is a resident.

osition. Similarly, a royalty regime would be preferential if it allowed the use of a non-arm's length transfer pricing method to calculate a reduced base relative to what an arm's length method would produce. For companies not engaged in an active trade or business in the treaty country, the target is a preferential rate or permanent base reduction of substantially all income or substantially all foreign income.[39]

Second, a reduced rate or base with respect to royalties will only be considered preferential if the taxpayer's access to the reduction is conditioned on performing research and development in the country.[40] This is a (modest) answer to so-called "patent box" regimes, which provide a low rate for income earned from the development of intangibles.[41] Patent boxes are no less a means of tax competition than any other, but they are popular among OECD countries and thus have been styled as acceptable tax competition within the BEPS project. Even so, the U.S. Model's location-based approach is distinct from the OECD's approach because the latter would allow a patent box conditioned on the taxpayer incurring research and development expenses in producing the tax-favored income.[42]

The third condition provides a minimum tax rate floor of either 15% or 60% of the general rate (whichever is lower).[43] This does

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39. *Id.* art. 3(1)(l)(i)(C). A footnote in the U.S. Model explains that "in the case of a regime that provides for both a preferential rate of taxation and a permanent reduction in the tax base, the rate of taxation would be based on the preferential rate of taxation reduced by the product of such rate and the percentage reduction in the tax base." *Id.* at 8 n. 1.

40. *Id.* art. 3(1)(l)(ii).

41. Patent, innovation, or "knowledge development" boxes are regimes designed to attract investment for the exploitation of valuable intangibles, many of which are developed as a result of research and development expenditures which may have been financed by other states, including the United States.

42. The OECD has adopted a modified nexus approach to condition the use of patent box regimes on the taxpayer undertaking "substantial activity" in the jurisdiction. *See* ORG. FOR ECON. CO-OPERATION & DEV. [OECD], COUNTERING HARMFUL TAX PRACTICES MORE EFFECTIVELY, TAKING INTO ACCOUNT TRANSPARENCY AND SUBSTANCE, ACTION 5 - 2015 FINAL REPORT 9 (2015) [hereinafter ACTION 5 FINAL REPORT]. The OECD approach appears to reflect the issue that location restrictions involving member states may not be compatible with European law. The U.S. Model language also appears to omit measures to address embedded intangibles. Future bilateral treaties will likely feature modified terms as a result of these and other issues.

43. 2016 U.S. MODEL, *supra* note 3, art. 3(1)(l)(iii), at 8 n. 1 ("For inclusion in an instrument reflecting an agreed interpretation . . . the rate of taxation

not appear to call for a minimum rate of 15%; rather, 15% would be the ceiling at which a rate would be considered a preferential tax rate; any rate higher than 15% would not be considered preferential even if the general rate is much higher. For example, if the general rate for interest was 2%, a rate of 1.5% would clear the hurdle because 60% of 2% is 1.2%. In such a case, the minimum tax floor would be defined as the lower of 15% or 1.2%, thus 1.2%. Conversely, if the general rate was 30%, a rate of 15% would clear the hurdle despite being half the general rate.

The fourth condition provides that the regime will only be preferential if it "does not apply principally" to a prescribed list of entities, among which are pensions, charities, and certain pooled investment vehicles.[44] For example, a rate of 5 percent will not be considered preferential if the rate principally applies to mutual funds that pay out their income annually. It remains to be seen whether these broad terms will be replicated verbatim in bilateral treaties going forward.

The fifth condition involves international relations: no special tax regime exists unless the accusing state consulted with the ostensibly offending state and thereafter identified the regime to the offending state through diplomatic channels. For example, if the U.S. Treasury determined that a treaty partner had adopted legislation described by the previous four conditions, it would need to consult with that country and then make a formal public statement that the law in question was a special tax regime before the characterization would apply.

Finally, the sixth condition is a time delay: thirty days must pass after the accusing state issues a written public notification as described in the fifth condition. The waiting period is not strictly defined as a condition in the treaty but the effect is that, even if the U.S. Treasury determined that a treaty partner had adopted legislation described by the first four conditions and completed its consultation and public notification steps, a regime will not be a tax regime until the following month. This would presumably grant time for taxpayers to rearrange their affairs prior to the loss of expected treaty benefits.

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shall be determined based on the income tax principles of the Contracting State that has implemented the regime in question."). This reflects an issue involving treaty interpretation that was not addressed in the draft form of the proposed provisions, as discussed *infra* Part II.

44. *Id.* art. 3(1)(l)(iv).

These six conditions address some of the concerns raised by commenters to the proposed language. Even so, several substantive and procedural questions remain. These will be addressed further in Part II.

C. Subsequent Changes in Law

The subsequent-changes-in-law proposal is distinct from the special tax regime proposal in both scope and the administrative discretion attached to its application. With the subsequent-change proposal, the U.S. Treasury seeks to switch off not only the treaty withholding rates provided in Articles 11, 12, and 21 (as it would in the presence of special tax regimes) but also in Article 10 (dividends) in certain circumstances. Those circumstances are described in the proposed new Article 28 as follows:

> 1. If at any time after the signing of this Convention, the general rate of company tax applicable in either Contracting State falls below 15 percent with respect to substantially all of the income of resident companies, or either Contracting State provides an exemption from taxation to resident companies for substantially all foreign source income (including interest and royalties), the provisions of Articles 10 (Dividends), 11 (Interest), 12 (Royalties) and 21 (Other Income) may cease to have effect pursuant to paragraph 4 of this Article for payments to companies resident in both Contracting States.
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> 2. If at any time after the signing of this Convention, the highest marginal rate of individual tax applicable in either Contracting State falls below 15 percent with respect to substantially all income of resident individuals, or either Contracting State provides an exemption from taxation to resident individuals for substantially all foreign source income (including interest and royalties), the provisions of Articles 10, 11, 12 and 21 may cease to have effect pursuant to paragraph 4 of this Article for payments to individuals resident in either Contracting State.[45]

The intent of these provisions seems clear: to deny treaty withholding rates on specified income items if a treaty partner reduces its corporate or individual tax rate below 15 percent or switches to a territorial regime. Further, in proposed form, these provisions were intended to affect the specified type of taxpayer

45. DRAFT PROVISIONS: ARTICLE 28, *supra* note 1, art. 28(1), (2).

as a class (corporate or individual, as the case may be). In final form, the effects are limited to corporations.[46]

The application of these provisions was not designed to be automatic. Instead, one party "may" notify the other that it "shall" ("will" in the proposed version) cease to apply the tax rate stated in the affected treaty articles.[47] If the party does so, the effect is to deny the treaty-based reduction in source-based taxation rates as to all companies in both jurisdictions.[48]

The final form is substantially similar to the proposed version but is rearranged and shortened owing to the omission of individuals from its scope. Article 28 reads in full as follows:

> 1. If at any time after the signing of this Convention, a Contracting State reduces the general statutory rate of company tax that applies with respect to substantially all of the income of resident companies with the result that such rate falls below the lesser of either (a) 15 percent or (b) 60 percent of the general statutory rate of company tax applicable in the other Contracting State, or the first-mentioned Contracting State provides an exemption from taxation to resident companies for substantially all foreign source income (including interest and royalties), the Contracting States shall consult with a view to amending this Convention to restore an appropriate allocation of taxing rights between the Contracting States. If such consultations do not progress, the other Contracting State may notify the first-mentioned Contracting State through diplomatic channels that it shall cease to apply the provisions of Articles 10 (Dividends), 11 (Interest), 12 (Royalties) and 21 (Other Income). In such case, the provisions of such Articles shall cease to have effect in both Contracting States with respect to payments to resident companies six months after the date that the other Contracting State issues a written public notification stating that it shall cease to apply the provisions of Articles 10 (Dividends), 11 (Interest), 12 (Royalties) and 21 (Other Income).
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> 2. For the purposes of determining the general statutory rate of company tax: a) the allowance of generally available deductions based on a percentage of what otherwise would be taxable income, and other similar mechanisms to achieve a reduction in the overall rate of tax, shall be taken into account; and b) a

46. 2016 U.S. MODEL, *supra* note 3, art 28(1).
47. DRAFT PROVISIONS: ARTICLE 28, *supra* note 1, art. 28(4); 2016 U.S. MODEL, *supra* note 3, art. 28(1).
48. 2016 U.S. MODEL, *supra* note 3, art. 28(1).

> tax that applies to a company only upon a distribution by such company, or that applies to shareholders, shall not be taken into account.[49]

As in the changes to the special tax rate definition, the revised subsequent-law change provision revises the minimum tax threshold to the "lower of 15% or 60% of the general statutory rate," which allows for source state rates below 15 percent as discussed above.[50] The final provision also introduces a time delay, but here the delay is six months rather than the thirty days allowed in the special tax regime provision. The reason for this marked difference in delay is not indicated in the treaty.

The scope of the subsequent-change-in-law provision is broad. Unlike the special tax regime, the kill-switch triggered by a subsequent change in law would not only apply to the company that benefits from the change but would also switch off the treaty rates for all companies that would otherwise be eligible for treaty benefits, whether or not they are eligible for the new low rate. This implies that both parties would override the treaty withholding rates and impose domestic law rates on the affected income items. The consultation process introduced in the U.S. Model suggests that the idea is to negotiate a change to the offending law rather than implement a change to the application of the treaty. Reciprocity, however, is the prescribed outcome barring diplomatic "progress."[51]

Reciprocity might seem like an unusual policy. If the United States triggers the kill-switch as a consequence for a treaty partner's reduction of domestic tax rates on its own residents, U.S. investors in the country might face the same consequence if the treaty partner reverts to domestic withholding tax rates that are higher than those provided in the treaty.[52] Where domestic tax rates on passive income are higher than that available in the

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49. 2016 U.S. MODEL, *supra* note 3, art. 28.

50. *See supra* text accompanying notes 34–36.

51. 2016 U.S. MODEL, *supra* note 3, art. 28(1).

52. For example, if, in the context of a treaty between the United States and State A, the United States invokes the subsequent-changes rule as to a reduction in the internal corporate tax rate on State A companies, State A companies with U.S.-source passive income would face domestic U.S. withholding tax rates instead of treaty rates on that income. State A, however, might then also impose its own potentially higher domestic rates on specified State A-source income earned by U.S. companies.

treaty, the result may not be beneficial to the United States.[53] For example, it does not benefit the United States if U.S. residents pay higher rates of tax to a treaty partner when higher source taxes would be eligible for credit against U.S. tax.[54]

U.S. companies might discourage foreign jurisdictions from adopting a prescribed regime when higher foreign tax rates might apply to them as a collateral effect and the credibility of such taxes is not certain.[55] On the other hand, the treaty-based and domestic withholding rates for foreign investment in some treaty-partner countries may be identical. Denial of a reciprocal treaty rate would have no effect in such cases, making U.S. investors indifferent to the kill-switch provisions.

The special tax regime and subsequent-law change provisions create interesting incentives in terms of creating the means to pressure foreign governments to align their tax regimes more closely to that of the United States. But are these wholly new

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53. Exceptions to this rule are unusual and may be the product of inattention. For instance, the 2004 treaty between Sri Lanka and the United States provides for a maximum withholding tax rate on specified income items that were higher than the domestic rate in Sri Lanka at the time the treaty was concluded. In reviewing the agreement, the Joint Committee on Taxation queried whether this was intended, and posited that perhaps Sri Lanka could raise its rates up the maximum 15 percent, thereby increasing its revenues from foreign investment. *See* STAFF OF THE J. COMM. ON TAXATION, 108TH CONG., EXPLANATION OF PROPOSED INCOME TAX TREATY BETWEEN THE UNITED STATES AND THE DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA 62 (Comm. Print 2004), https://www.jct.gov/publications.html?func=startdown&id=3523 (noting that "it is not clear that . . . Sri Lankan laws have been fully taken into account" since "[s]everal of the articles of the proposed treaty contain provisions that are less favorable to taxpayers than the corresponding rules of the internal Sri Lankan tax laws.").

54. That is, a U.S. company that faces a residual tax rate of 35 percent in the United States may be indifferent to a foreign tax rate up to 35 percent so long as it is fully offset by the U.S. foreign tax credit. Accordingly, if State A taxes at a higher rate under domestic law than under the treaty, and the tax is fully creditable, the effect is to shift revenue from the United States to State A.

55. Comparatively high U.S. marginal tax rates are said to make U.S. multinationals uncompetitive vis-à-vis their foreign counterparts. *See, e.g.*, *Offshore Profit Shifting and the U.S. Tax Code - Part 2 (Apple Inc.)*: *Hearing Before the Permanent Subcomm. on Investigations of the S. Comm. on Homeland Sec. & Governmental Affairs*, 113th Cong. (2013) (testimony of Tim Cook, Chief Executive Officer, Apple Inc.), http://www.hsgac.senate.gov/subcommittees/investigations/hearings/offshore-profit-shifting-and-the-us-tax-code_-part-2. Leveling the global playing field by raising the tax rates on competitors may be a motivation for favoring increased foreign tax rates on foreign taxpayers.

features and functions of tax treaties? A textual search of other treaties suggests not: these kinds of provisions are relatively rare but not exceptional in the global tax treaty network. Some precedents are explored in the following Part.

II. NEGOTIATED OVERRIDE: UNUSUAL BUT NOT UNPRECEDENTED

A look around the global tax treaty network yields a few examples of precedent for turning off treaty benefits in the case of special tax regimes and subsequent-law changes. Scarce relative to the volume of bilateral treaties based on the OECD, U.N., and U.S. Models, the examples are mainly confined to agreements between capital-exporting countries and countries that impose little or no taxation on income that would be earned from the treaty partner country. Beyond these agreements are more ubiquitous treaty provisions that may be seen as precedents to the proposals, namely, some "subject to tax" clauses and, in some fashion, so-called "saving" clauses.[56]

To the extent that treaties have been viewed as intending to eliminate double taxation where two countries seek to impose taxation on the same income item earned by the same taxpayer, it is not clear why treaties should exist at all in the absence of that phenomenon. Exist they do, however. The language limiting treaty benefits, either as to specified taxpayers or specified types of income, appears necessary to preserve the treaty partner's tax base, reallocates the taxing jurisdiction back to the residence state where the source state declines to tax. Expanding this language to the U.S. Model, which implies an intent to introduce these provisions as to most or all future treaty partners, seems designed to fulfill a distinct function.

Accordingly, it is worthwhile to examine the existing examples, both in terms of their textual relationship to the proposals as well as in terms of how they affect the relationship between the treaty partners. In a search of the U.N. Treaty Series, we located a number of tax treaties with various provisions that

56. General limitations on benefit provisions are also precedents to some extent, but they differ from provisions that target specified taxpayers or types of income in the treaty partner country.

share characteristics with the special tax regime and subsequent-law change mechanisms proposed by the U.S. Treasury.[57] Grouped by concept, these are discussed in turn.

A. Special Tax Treatment

Several treaties within the worldwide bilateral tax treaty network contain the term "special tax treatment," the definition of which appears to correspond closely to the special tax regime proposal. These treaties range in date from 1966 through 2000, but most date to the 1960s and early 1970s and involve a set of arrangements between France and its former African colonies.[58] The most pertinent example, however, is found in the Czech Republic-Philippines 2000 tax treaty, which provides:

> The provisions of this Convention shall not apply to income derived by companies or other persons enjoying a special tax treatment by virtue of the laws or administrative practice of either of the Contracting States as long as the rates of tax applicable to these companies or persons do not exceed the limitations provided for in the Convention.[59]

In this treaty, the special tax treatment clause is one of three clauses intended to prevent treaty shopping and treaty abuse; the other two provide a general anti-avoidance rule and preserve the applicability of domestic and general special anti-avoidance rules, including substance over form.[60]

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57. Treaties were identified by searching a number of terms based on the special tax regime proposal and subsequent-changes proposals, including "special," "tax regime," "tax benefit," "tax treatment," "holding companies," "cease to have effect," and "relieved from tax." A complete list of findings is on file with the authors and available upon request. Not all treaties are included in the U.N. series, so the analysis is confined to a subset of tax treaties that are accessible by general search.

58. List on file with the authors. The countries that have treaties with this language are: Algeria, Benin, Cameroon, Central African Republic, Congo, Cote d'Ivoire, the Czech Republic, France, Gabon, Mali, Mauritania, Philippines, Senegal, Togo, and Tunisia.

59. Convention Between the Republic of the Philippines and the Czech Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (as amended by Protocol), Czech.-Phil., Protocol, Nov. 13, 2000, 2756 U.N.T.S. 11.

60. *Id.* ("Benefits provided under this Convention shall not be granted also to companies of either Contracting State if the purpose of the establishment of such companies was solely to obtain benefits under this Convention that would not otherwise be available. The provisions of this Convention shall in no case

The tax treaties entered into by France and its former African colonies have similar provisions but do not mention administrative practice. For example, the Benin-France 1972 tax treaty states:

> Where the distributed profits include earnings from holdings of the company in the capital of other companies and such holdings fulfil the conditions under which affiliated companies are accorded special tax treatment under the internal legislation either of the State in which the company has its fiscal domicile or of the other State, . . . each State shall apply . . . its internal legislation . . . , while that part of the said distributed profits which does not consist of earnings from such holdings shall be taxed by each State in accordance with the manner of apportionment provided for [in the treaty].[61]

Several similarities associate the proposed special tax regime clause in the U.S. Model with the special tax treatment provision found in the Czech Republic-Philippines treaty (less so with respect to the other treaties with this term). First, the special tax treatment provision clearly contemplates administrative practice as a source of reduced tax rates.[62] In addition, the provision makes minimum domestic tax rates a prerequisite to eligibility for treaty-based withholding rates.[63] Finally, by implication, the special tax treatment clause, like the special tax regime proposal of the United States, denies treaty benefits to recipients of reduced tax rates owing to subsequent changes in law in either contracting state.[64]

Under the Czech Republic-Philippines treaty and others in the bilateral treaty network, however, only those taxpayers actually receiving the reduced domestic rate would be excluded from

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prevent either Contracting State from the application of the provisions of its domestic laws aiming at the prevention of fiscal evasion, in particular, but is not limited to, the provisions on thin capitalisation, transfer pricing, and substance over form.").

61. Tax Agreement Between the Government of the French Republic and the Government of the Republic of Dahomey (now Benin), Benin-Fr., art. XV(3), Feb. 27, 1975, 1088 U.N.T.S. 301.

62. As such, the treaty suggests that access to each other's administrative practices would be available to the treaty partners.

63. In this case, the stated minimum rate is the treaty rate.

64. It is not clear whether this implication was intended. Research yielded no evidence that the provision has ever been used by the parties to deny treaty benefits in response to subsequent-law changes, but it is not clear whether such evidence, if it existed, would be publicly available.

treaty benefits; moreover, these taxpayers would be completely excluded from the treaty rather than only denied the benefit of targeted provisions (as provided in the special tax regime and subsequent-change proposals).[65]

B. Special Tax Benefits

Similar to the special tax treatment clause, several bilateral tax treaties contain provisions limiting tax treaty withholding rates where a specified company received a "special tax benefit."[66] These treaties range in date between 1965 (Jamaica-United Kingdom) and 2003 (Estonia-Malta). The United Kingdom, for example, has six treaties containing the term, while Jamaica and Malta each have four.[67] At one time, the United States had a treaty with the Netherlands that contained the term, but it expressly applied to situations involving the Netherlands Antilles.[68] The current U.S.-Netherlands treaty does not contain a similar term.[69]

The treaties involving Jamaica provide an illustration. Until 2014, Jamaica had a regime for specified "international finance companies," which were entitled to a reduced rate of two and a

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65. In addition, the special tax regime provisions only cover payments involving related parties. As such, provisions like that in the Czech Republic-Philippines treaty compare to a general limitation on benefits provision as much or more than they compare to the kill-switch proposals.

66. A search of the Hein World Treaty Index yields sixteen treaties with this text, involving seventeen countries (several are repeat players): Barbados, Belgium, Canada, Cyprus, Estonia, Finland, France, Ireland, Jamaica, Latvia, Luxembourg, Malaysia, Malta, the Netherlands, Sweden, the United Kingdom, and the United States.

67. *See, e.g.*, Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion, Belg.-Malta, June 28, 1974, 997 U.N.T.S. 49; Canada-Jamaica Income Tax Agreement, Can.-Jam., art. IX, Jan. 4, 1971, 977 U.N.T.S. 183.

68. Convention Between the United States of America and the Kingdom of the Netherlands with Respect to Taxes on Income and Certain Other Taxes, Neth.-U.S., art. VI, Apr. 29, 1948, 32 U.N.T.S. 167.

69. This may be because the benefits of the U.S.-Netherlands tax treaty no longer extend to the Netherlands Antilles.

half percent on specified profits.[70] Jamaica's treaties with Canada,[71] France,[72] Sweden,[73] and the United Kingdom[74] responded to this nominal rate by denying application of the treaty to companies "entitled to any special tax benefit" under the regime.

A number of treaties exclude specified holding companies from treaty benefits for the same reason, without necessarily invoking the language of "special benefits."[75] Most of these treaties involve Luxembourg, including a 1962 treaty with the United States.[76] For example, Article 28 of the Luxembourg-Sweden tax treaty states:

> This Convention shall not apply to holding companies within the meaning of the special laws of Luxembourg . . . . It also

70. International Finance Companies (Income Tax Relief) Act, § 5(1) (1971) (Jam.). The law was repealed as of January 1, 2014, with a grandfathering clause extending tax relief to persons who were granted approval prior to the repeal until expiration in accordance with the terms of the applicable approval certificate. *See Jamaica – Corporate Tax Credits and Incentives*, PRICEWATERHOUSECOOPERS.COM, http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/Jamaica-Corporate-Tax-credits-and-incentives (last visited Aug. 15, 2016).

71. Canada-Jamaica Income Tax Agreement, *supra* note 67, art. IX ("This Agreement shall not apply to companies entitled to any special tax benefit under the [International Finance Companies (Income Tax Relief) Act] . . .").

72. Convention Between the Government of the French Republic and the Government of Jamaica for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Fr.-Jam., art. 27, Aug. 9, 1995, 2089 U.N.T.S. 3.

73. Convention Between the Government of Jamaica and the Government of Sweden for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Jam.-Swed., art. 28, Mar. 13, 1985, 1427 U.N.T.S. 297.

74. Agreement Between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of Jamaica for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Jam.-N. Ir.-U.K., art. XVIII A, May 9, 1969, 699 U.N.T.S. 350.

75. Convention Between the Kingdom of Sweden and the Grand Duchy of Luxembourg for the Avoidance of Double Taxation and the Establishment of Rules for Mutual Administrative Assistance with Respect to Taxes on Income and Capital, Lux.-Swed., art. 28, Mar. 13, 1985, 1409 U.N.T.S. 291.

76. Convention Between the United States of America and the Grand Duchy of Luxembourg with Respect to Taxes on Income and Property, Lux.-U.S., art. XV, Dec. 18, 1962, 15 U.S.T. 2355.

> shall not apply to the income which a resident of Sweden derives from such companies or to the capital shares or other securities which that person owns in such companies.[77]

Provisions like this one are found in other current[78] and former U.S. treaties[79] and in a current treaty between Chile and Switzerland.[80] These precedents are instructive, though those involving the United States predate the general limitation on benefits provisions that are now ubiquitous in all U.S. tax treaties.[81]

The current Trinidad and Tobago treaty, which dates to 1970, and the former Finland-U.S. and Iceland-U.S. tax treaties, which date to 1971 and 1975, respectively, share a virtually identical article to limit benefits in the case of certain investment or holding companies. The Trinidad treaty, which is still in force, states:

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77. Convention for the Avoidance of Double Taxation, Lux.-Swed., *supra* note 75. In some treaties, the residence country agrees to exempt dividends received by their residents from the treaty partner country; this type of provision might prevent that result. As such, the provision is distinct from the special tax regime provision, which focuses on source-country tax benefits rather than those offered by the residence country.

78. Convention Between the United States of America and Trinidad and Tobago for the Avoidance of Double Taxation, the Prevention of Fiscal Evasion with Respect to Taxes on Income, and the Encouragement of International Trade and Investment, Trin. & Tobago-U.S., art. 16, Jan. 9, 1970, 22 U.S.T. 164.

79. Convention Between the United States of America and the Republic of Iceland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, Ice.-U.S., art. 27, May 7, 1975, 26 U.S.T. 2004; Convention Between the United States of America and the Republic of Finland with Respect to Taxes on Income and Property, Fin.-U.S., art. 27, Mar. 6, 1970, 22 U.S.T. 40. This treaty was replaced in 1989; the new treaty eliminated Article 27 and added the now standard limitation on benefits clause. Convention Between the Government of the United States of America and the Government of the Republic of Finland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital, Fin.-U.S., art. 16, Sept. 21, 1989, T.I.A.S. No. 12,101.

80. Convention Between the Swiss Confederation and the Republic of Chile for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital, Chile-Switz., Apr. 2, 2008, 2712 U.N.T.S. 91 (denying treaty rates on specified income items in the case of conduit arrangements).

81. The first U.S. Model to include such a provision was the 1981 version. U.S. MODEL INCOME TAX CONVENTION art. 16 (U.S. DEP'T OF THE TREASURY 1981).

> A corporation of one of the Contracting States deriving dividends, interest, or royalties from sources within the other Contracting State shall not be entitled to the benefits of Article 12 (Dividends), 13 (Interest), or 14 (Royalties) if-
>
> (a) By reason of special measures granting tax benefit to investment or holding companies the tax imposed on such corporation by the first-mentioned Contracting State with respect to such dividends, interest, or royalties is substantially less than the tax generally imposed by such Contracting State on corporate profits and,
>
> (b) Twenty-five percent or more of the capital of such corporation is held of record or is otherwise determined, after consultation between the competent authorities of the Contracting States, to be owned, directly or indirectly, by one or more persons who are not residents of the first-mentioned Contracting State (or, in the case of a Trinidad and Tobago corporation, who are citizens of the United States).[82]

The intention behind these types of special tax benefits provisions aligns with the special tax regime proposal in that it denies treaty benefits to companies protected against double taxation by virtue of a domestic tax regime. They are distinct, however, from the special tax regime proposal in several respects.

First, the special tax benefits provisions appear to target treaty shopping and, therefore, are concerned with ownership, while ownership is irrelevant to the special tax regime. Second, the terms of the special benefits rule appear limited to companies specified at the time the treaty is concluded, and it is not clear whether they would be extended to subsequently enacted regimes.[83] There are no references to diplomatic procedures as there are in the new kill-switch provisions.[84] In addition, there is no role for administrative practice in this type of provision.[85] Finally, as in the case of the special tax treatment provision in

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82. Convention for the Avoidance of Double Taxation, Trin. & Tobago-U.S., *supra* note 78, art. 16. The pertinent text is virtually identical to Article 27 of the Finland-U.S. tax treaty signed in 1970. Convention with Respect to Taxes on Income and Property, Fin.-U.S., *supra* note 79, art. 27.

83. For example, this is the case in Convention for the Avoidance of Double Taxation, Lux.-Swed., *supra* note 75.

84. *See supra* discussion at Part I.B., C.

85. By contrast, the proposed and final text of the new kill-switches contemplated the possibility that administrative practice would deviate from statutory prescriptions. *See* SELECT DRAFT PROVISIONS, *supra* note 1, arts. 3 (Technical Explanation for Definition of "special tax regime"), 11(2)(c).

the Czech Republic-Philippines treaty, the provisions are not reciprocal in scope; only specified taxpayers would be excluded from treaty benefits.[86]

C. Subject to Tax

A number of bilateral tax treaties seek to expressly disallow the application of a treaty where the recipient is not subject to tax on a given type of income. These provisions are precedents to the proposed kill-switches because they provide for taxation not in accordance with the treaty in order to prevent double non-taxation in specified instances. These provisions do not appear to have been used or understood to partially terminate or override treaty terms in the same manner as the special tax regime and subsequent-law change provisions.

Subject to tax provisions come in various forms. One example is the so-called "remittance-based tax" clause, which is found in several treaties and was included in the Commentaries to the OECD Model in 2003.[87] This clause is an answer to double non-taxation that is created owing to a specific form of territorial taxation under which a country only taxes income that is remitted or received in the country. The Commentaries to the OECD Model explain:

> Under the domestic law of some States, persons who qualify as residents but who do not have what is considered to be a permanent link with the State (sometimes referred to as domicile) are only taxed on income derived from sources outside the State to the extent that this income is effectively repatriated, or remitted, thereto. Such persons are not, therefore, subject to potential double taxation to the extent that foreign income is not remitted to their State of residence and it may be considered inappropriate to give them the benefit of the provisions of the Convention on such income. Contracting States which agree to restrict the application of the provisions of the Convention to income that is effectively taxed in the hands of these persons may do so by adding the following provision to the Convention:
>
> Where under any provision of this Convention income arising in a Contracting State is relieved in whole or in part from

86. Convention for the Avoidance of Double Taxation, Czech.-Phil., *supra* note 59, at 42.

87. A search of treaties in the United Nations Treaty Series yielded thirteen results of the "remittance-based tax" clause.

> tax in that State and under the law in force in the other Contracting State a person, in respect of the said income, is subject to tax by reference to the amount thereof which is remitted to or received in that other State and not by reference to the full amount thereof, then any relief provided by the provisions of this Convention shall apply only to so much of the income as is taxed in the other Contracting State.[88]

The United States has included remittance clauses within its general limitation on benefits article (e.g., in the tax treaty with Malta, which has a remittance regime).[89] The language is not in the existing U.S. Model, nor is it in the proposed revision of the limitation on benefits clause.[90] Remittance clauses are consistent with the special tax regime and subsequent-change provisions, even if existing precedents are distinct.

For example, like the special tax regime and subsequent-change proposals and unlike special tax benefits and holding company clauses, the standard remittance clause is broadly applicable to any person, presumably now or ever. The remittance clause targets, in general terms, a specific type of tax regime in order to be broadly applicable. It is silent as to administrative practice. Finally, consistent with the special tax regime and subsequent-change proposals and unlike a more general limitation on benefits provision, taxpayers would not be completely excluded from the treaty under a remittance clause but only denied the benefit of provisions related to untaxed income.

D. Saving Clauses

Lastly, and perhaps underappreciated for this use, the saving clause found in most U.S. tax treaties is something of a precedent for using special tax regime and subsequent-change rules to counter double non-taxation. In U.S. practice, the saving clause denies U.S. citizens and residents the ability to use U.S. tax treaties to reduce their U.S. taxes, except as specifically provided.

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88. ORG. FOR ECON. CO-OPERATION & DEV. [OECD], COMMENTARIES ON THE ARTICLES OF THE MODEL TAX CONVENTION art. 1, para. 26.1 (2010).

89. Convention Between the Government of the United States of America and the Government of Malta for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Malta-U.S., art. 22(7), Aug. 8, 2008, T.I.A.S. 10-1123.

90. DRAFT PROVISIONS: ARTICLE 22, *supra* note 15.

The clause, found in all U.S. tax treaties, generally states, *inter alia*, that "[e]xcept to the extent provided, . . . this Convention shall not affect the taxation by a Contracting State of its residents (as determined under Article 4 (Resident)) and its citizens."[91] Following prompting from the United States, the OECD proposed the addition of a similar clause to the OECD Model.[92] The main point of a saving clause is to prevent taxpayers from using tax treaties to reduce domestic taxes in their countries of residence; but, at least one precedent suggests that the saving-clause concept may be revised to fulfill a function similar to the special tax regime. It does so by switching the focus from the nature of the taxpayer to income and reverting to domestic law in specified situations of non-taxation by the treaty partner. Specifically, the Netherlands-Venezuela 1991 tax treaty provides:

> When according to the provisions of this Convention income shall be relieved from tax in the Netherlands, and that income according to the law in force in Venezuela in considered to be foreign-source income and for that reason is exempt from tax in Venezuela, the Netherlands may tax such income as if the Convention has not come into effect.[93]

This variation on a saving clause echoes the subject to tax clause and may ensure that income is taxed in one of the contracting states if the other declines to tax it. Of course, the ultimate out-

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91. 2006 U.S. MODEL, *supra* note 6, art. 1, para 4.

92. ACTION 6 FINAL REPORT, *supra* note 9, para. 62 (stating the addition of a saving clause implicates a number of other provisions in a tax treaty). The OECD further notes that

> [d]uring the work on the [saving-clause] provision, a number of issues related to relief of double taxation were discussed. It was agreed that, as a matter of principle, . . . the OECD Model only required a Contracting State to relieve double taxation when income was taxable in the other State . . . . [The draft proposal] was put forward during the last stages of that work in order to confirm that principle.

Id. para. 64.

93. Convention Between the Kingdom of the Netherlands and the Republic of Venezuela for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (with Protocol), Neth.-Venez., Protocol, May 29, 1991, 2288 U.N.T.S. 103.

come depends on there being an applicable tax according to domestic law in the treaty country seeking to apply the provision (in this case the Netherlands).[94]

Again, a saving clause bears some relation to the special tax regime and subsequent-change provisions, albeit indirectly compared to the foregoing examples. It provides a general reversion to domestic law in specified cases but not a complete exclusion from treaty applicability—the taxpayer is still entitled to other provisions. The Netherlands-Venezuela version is triggered by the non-taxation of income in the treaty partner country rather than by the classification of the taxpayer (as the standard U.S. saving clause provides). Like the special tax regime proposal, only the affected taxpayer is denied the treaty benefit. There may be no role for administrative practice, however, since the provision refers only to the "law in force."

Thus, although rare in number, a few precedents do exist for the special tax regime and subsequent-change proposals. These are but a few examples, as there are likely others within the broad worldwide treaty network of over three thousand bilateral agreements. The precedents considered here have arisen in treaties concluded among a range of countries over the years, in different guises and for varying purposes. Contextualized, the U.S. Treasury's special tax regime and subsequent-change proposals should be seen as adding a variation to existing safeguards rather than a wholly new approach. Even so, the implications of making these provisions standard should be analyzed. A few of the implications are discussed in the next Part.

III. IMPLICATIONS

In the introduction, this article posited that a kill-switch is a useful mechanism to avoid a potentially more problematic outcome, but that does not mean that a kill-switch is without its own issues. The U.S. Treasury's idea of adding partial termination provisions to address special tax regimes and subsequent changes in law appears potentially motivated to accomplish two goals: first, to endorse some version of the single tax principle (at least, more clearly than has been accomplished in the past) and second, to forestall some other outcome in the event of the adoption by a treaty partner of an offending regime, including

94. If not, double non-taxation would seem to occur with or without the treaty.

full termination and new treaty formation. The reasons for avoiding these outcomes likely include international diplomatic and political considerations as well as internal political procedural ones. These issues and motivations are worth understanding for the purpose of considering whether the kill-switch mechanism represents a new vision for the U.S. Model treaty.

A. *Endorsing the Single Tax Principle*

Denial of treaty benefits to specified taxpayers in regards to specified-income types makes sense if a goal of a tax treaty is to prevent double taxation rather than to eliminate taxation altogether. The question, which currently is being developed by the OECD in connection with the BEPS proposal, is whether this is or should be the goal of tax treaties. This inquiry, together with all of the treaty-benefit limiting provisions discussed herein, may be associated with the idea of the "single tax principle," which holds that all income should ultimately be taxed once, and only once. Ensuring that an item of income is only taxed once may be accomplished by exemptions, credits, and shared allocation of tax under a treaty.

The single tax principle is controversial both in terms of its existence as a recognizable principle and in terms of its acceptance on the merits. Reuven Avi-Yonah has suggested that the international tax regime is built upon this principle that, generally, income should be taxed primarily by the country where it arises.[95] Others are more skeptical.[96] Nevertheless, the

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95. Reuven S. Avi-Yonah, *Who Invented the Single Tax Principle? An Essay on the History of U.S. Treaty Policy*, 59 N.Y.L. SCH. L. REV. 305, 309 (2014–2015) (stating that the single tax principle allocates tax according to the type of income, such that "cross-border income should be taxed only once at the source-country rate for active income and at the residence-country rate for passive income."). For a complementary view, see Hugh J. Ault, *Some Reflections on the OECD and the Sources of International Tax Principle*s, 70 TAX NOTES INT'L 1195, 1195 (2013).

96. For example, Avi-Yonah points to David Rosenbloom, who is also skeptical about the existence of an international tax regime, as well as Michael Graetz, Julie Roin, and Dan Shaviro. Avi-Yonah, *supra* note 95, at 311; *see* H. David Rosenbloom, *The David R. Tillinghast Lecture International Tax Arbitrage and the "International Tax System,"* 53 TAX L. REV. 137, 166 (2000) (stating that "[i]nvoking the international tax system does not constitute an explanation, since that system appears to be imaginary.").

OECD is arguably adopting the principle in major respects through the BEPS Initiative.[97]

Opponents of the single tax principle provide various arguments against the concept, often in the name of tax policy autonomy. An example of this argument that has not been discussed at the level of the OECD, but which implicates many non-OECD countries, is that the single tax principle would eliminate certain types of (non-OECD approved) tax incentive structures even while preserving the prerogatives of OECD members in protecting their own incentive regimes. For instance, the single tax principle enforced by treaty might signal a consensus against tax sparing even if it would apparently not interfere with other incentives like the patent box regimes becoming so popular in OECD countries.

Tax sparing refers to the practice by which treaty partners seek to ensure that tax incentives granted to their resident investors by source countries are not "cancelled out" by residual income taxation in the residence country.[98] This is typically accomplished through a treaty by ensuring that the residence country gives credit for the amount of tax that would have normally been paid to the source country instead of a reduced (or eliminated) amount that was actually paid according to an incentive scheme.[99]

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97. *See, e.g.*, ACTION 6 FINAL REPORT, *supra* note 9; *see also* ORG. FOR ECON. CO-OPERATION & DEV. [OECD], PUBLIC DISCUSSION DRAFT, BEPS ACTION 6: PREVENTING THE GRANTING OF TREATY BENEFITS IN INAPPROPRIATE CIRCUMSTANCES (2014).

98. Tax sparing was first proposed in the United Kingdom by the British Royal Commission, which prepared a report in 1953 recommending the policy as a means of "aiding British investment abroad." ORG. FOR ECON. CO-OPERATION & DEV. [OECD], TAX SPARING: A RECONSIDERATION 15 (1998). Ultimately rejected after several years of debate, the policy was nevertheless introduced in U.K. tax treaties as a result of legislative action in 1961.

99. For an overview, see Richard D. Kuhn, *United States Tax Policy with Respect to Less Developed Countries*, 32 GEO. WASH. L. REV. 261, 262–64 (1963). For calls to continue the policy, see Karen B. Brown, *Missing Africa: Should U.S. International Tax Rules Accommodate Investment in Developing Countries?*, 23 U. PA. J. INT'L ECON. L. 45, 80 (2002); Damien Laurey, *Reexamining U.S. Tax Sparing Policy with Developing Countries: The Merits of Falling in Line with International Norms*, 20 VA. TAX REV. 467, 483–84 (2000) (arguing that developing countries "need tax holidays to attract foreign investment," and therefore advocating for tax sparing to counter the effect of residual home country taxation).

An example of treaty-based tax sparing is found in Article 21 of the 1993 tax treaty between Indonesia and the United Kingdom, which states: "For the purposes of paragraph (1) of this Article, the term "Indonesian tax payable" shall be deemed to include any amount which would have been payable as Indonesian tax for any year but for an exemption or reduction of tax granted for the year . . . ." [100] In this type of tax sparing provision, an amount of tax would be credited by a taxpayer's residence country in accordance with the standard double tax relief provisions of the treaty (despite not ultimately being paid to the source country). Therefore, treaty-based tax sparing purposefully creates the means for double non-taxation through deliberate cooperation of the treaty partners.

As a policy, tax sparing has never been accepted by the United States as a valid feature of tax treaties precisely owing to its production of double non-taxation.[101] As applied to U.S. tax treaties, the incompatibility of the single tax principle with tax sparing would represent no change in policy.

The situation is potentially more controversial when globalized through the OECD in the form of minimum standards or best practices. Since 1998 the OECD has rejected tax sparing as a self-destructive form of tax competition,[102] yet the selectiveness of attention to this issue has the disadvantage of appearing

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100. Agreement Between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Indonesia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, Indo.-N. Ir.-U.K., Apr. 5, 1993, 2038 U.N.T.S. 303.

101. As well as for its violation of the principle that treaties should not be used to reduce domestic taxation of U.S. persons. For a discussion, see Christians, *supra* note 4. Tax sparing was contemplated and even proposed for inclusion in one treaty (with Pakistan), but it was ultimately rejected by the United States, largely due to the vigorous opposition of Stanley Surrey. *See* Stanley S. Surrey, *The Pakistan Tax Treaty and "Tax Sparing,"* 11 NAT'L TAX J. 156, 167 (1958). For a review of the phenomenon, see Kim Brooks, *Tax Sparing: A Needed Incentive for Foreign Investment in Low Income Countries or an Unnecessary Revenue Sacrifice*, 34 QUEEN'S L.J. 505 (2009). For an argument that tax sparing increases foreign direct investment and its withdrawal is associated with increased foreign aid, see Céline Azémar & Dhammika Dharmapala, *Tax Sparing, FDI, and Foreign Aid: Evidence from Territorial Tax Reforms* (Univ. of Chi. Coase-Sandor Inst. for Law & Econ., Working Paper No. 758, 2016), http://ssrn.com/abstract=2767184.

102. OECD, *supra* note 98, at 41, 83.

to disproportionately violate the tax policy autonomy of countries that are not OECD members.[103]

B. Without a Kill-Switch, What?

Beyond the general policy autonomy question is a more specific question of autonomy with respect to the parties to a treaty that includes kill-switch provisions. A kill-switch might be a viable alternative to what may be viewed as the most serious consequence of a party's dashed expectations in an existing treaty, namely, full termination of the agreement. Partial termination avoids this more catastrophic result. Total termination, however, has been a rarity in U.S. tax treaty practice.[104]

Dissatisfaction with an existing tax treaty between the United States and one of its treaty partners typically appears to be met by negotiation of a protocol or a wholly new treaty in due course. Treaty negotiation and ratification is a lengthy and cumbersome process that involves diplomacy and power politics and therefore takes time and administrative effort. An offended party may live with an unsatisfactory treaty for some time.[105] For the same reason, the prescribed diplomatic procedures for renegotiation in

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103. Most countries lack tax policy autonomy to some degree or another due to global economic pressure and geopolitics, but discouraging tax sparing may be viewed as a more direct interference with the policy goals of non-OECD countries. *See* Allison Christians, *Global Trends and Constraints on Tax Policy in the Least Developed Countries*, 42 U.B.C. L. REV. 239 (2010).

104. Most U.S. tax treaty terminations have involved terminating the extensions of treaties with Belgium, the Netherlands, New Zealand, and the United Kingdom to their respective offshore possessions and former colonies. *See, e.g.*, *Tax Evasion Through the Netherlands Antilles and Other Tax Haven Countries: Hearing Before the Subcomm. of Commerce, Consumer, and Monetary Affairs of the H. Comm. on Gov't Operations.*, 98th Cong. 275–76 (1983); Vincent P. Belotsky, Jr., *The Prevention of Tax Havens via Income Tax Treaties*, 17 CAL. W. INT'L L.J. 43, 67–68 (1987). The United States terminated its treaty with South Africa for nontax reasons, pursuant to the terms of the Comprehensive Anti-Apartheid Act of 1986. It reinstated the treaty once the regime was abandoned. *See* Convention Between the Government of the United States of America and the Republic of South Africa for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, S. Afr.-U.S., Feb. 17, 1997, S. TREATY DOC. No. 105-9.

105. In the context of contemporary U.S. tax relations with the rest of the world, tax treaty negotiation currently involves risk of failure due to internal politics. This issue may mean that the parties have to live with existing tax treaties indefinitely, making changes to the U.S. Model immaterial in the short-term. *See, e.g.*, Patrick Temple-West, *U.S. Senator Paul Won't Budge on*

Article 28 of the U.S. Model may weaken the efficiency of the kill-switch provisions.[106]

Thus, the partial termination afforded by a kill-switch may not be perceived as a remedy to full termination but rather the opposite: working indefinitely with a treaty that sacrifices some policy goals in order to preserve others. Partial termination itself will equally sacrifice some policy goals in order to preserve others. Of course, treaties by their nature represent policy compromises undertaken by the parties. In general, however, these are negotiated policy compromises. The inclusion of a kill-switch in the U.S. Model treaty may enable the parties to pressure each other to effectively renegotiate the treaty while avoiding lengthy internal ratification procedures (which may encounter potential internal political barriers).[107]

C. Interpretation Implications

Finally, a kill-switch raises interpretation and dispute resolution issues in both international and domestic law. First, a treaty partner might not agree that a breach has in fact occurred to justify the override in a given set of circumstances. If not, actually engaging the switch at some future date could raise issues of international law, process, and politics, even if both parties agreed upon the mechanism in principle at the time the treaty was signed.

Blocking Tax Treaties, REUTERS (June 4, 2014), http://www.reuters.com/article/usa-tax-treaties-idUSL1N0OL1J920140604 (describing the stalling of U.S. tax treaty ratification owing to the efforts of a U.S. senator who objected to certain features involving information exchange).

106. It remains to be seen how a lack of "progress" in consultation affects the implementation of these kill-switch regimes. *See* 2016 U.S. MODEL, *supra* note 3, art. 28(1).

107. *See* CONG. RESEARCH SERV., 106TH CONG., TREATIES AND OTHER INTERNATIONAL AGREEMENTS: THE ROLE OF THE UNITED STATES SENATE 18 (Comm. Print 2001), https://www.govinfo.gov/content/pkg/CPRT-106SPRT66922/pdf/CPRT-106SPRT66922.pdf ("The Constitution is silent on procedures for modifying or terminating treaties, and agreement has not been reached between the branches on a single proper mode. The general rule is that international agreements are to be amended in the same way that they were made, thus for treaties requiring the advice and consent of the Senate. With the increase in numbers and complexity of treaties, more frequent changes and adjustments have become necessary. The Senate has again been challenged to be vigilant for unilateral executive branch action that might change a basic obligation agreed to in its advice and consent to a treaty.").

In the case of special tax regimes identified as such in the course of treaty negotiation, the provision amounts to a simple carve out. This is not a significant departure from past treaty practice in the United States, or internationally for that matter, as illustrated above. As drafted, however, the provisions are not limited to the regimes agreed to ahead of time and listed in the definitions. Instead, they would apply to specified future regimes that reduce a described taxpayers' tax rate for specified income items relative to the general rate.[108]

The proposed special tax regime definition and the new interest, royalty, and other income paragraphs are silent as to how states will make determinations about regimes that are not identified as special tax regimes during treaty negotiations.[109] They are also silent regarding how parties would deal with disputes that relate to the characterization of a regime as a special tax regime. The fact that a special tax regime would apply in response to an administrative practice creates some detection difficulty, since the United States would not necessarily have access to a treaty partner's relevant taxpayer-specific rulings.[110] Implementation of the OECD's recommendations for countries to begin sharing tax rulings on an automatic basis may lend assistance in this regard.[111]

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108. In proposed form, it was not clear whether notice would be given to taxpayers and withholding agents as to the change in rate. In July 2015 IRS International Tax Counsel Danielle Rolfes stated that the special regime definition would not be self-executing, and that the treaty partners "would be able to agree that a particular regime is not a special regime." Sheppard, *supra* note 31. The final versions in Article 28 of the U.S. Model treaty address this issue.

109. It is not clear what would happen in a case of disagreement among treaty partners as to a future characterization of a special tax regime.

110. The so-called "Lux Leaks" whistleblower revealed that delivering tax benefits through administrative rulings was a widespread practice. For a discussion, see Allison Christians, *Lux Leaks: Revealing the Rule of Law, One Plain Brown Envelope at a Time*, 76 TAX NOTES INT'L 1123 (2014). The OECD's response is automatic exchange of tax rulings. *See* ACTION 5 FINAL REPORT, *supra* note 42, at 45–54; *see also* ACTION 6 FINAL REPORT, *supra* note 9.

111. *See* ORG. FOR ECON. CO-OPERATION & DEV. [OECD], MANDATORY DISCLOSURE RULES, ACTION 12 - 2015 FINAL REPORT 79–82 (2015) [hereinafter ACTION 12 FINAL REPORT] (noting that "[t]he transparency framework developed by the Forum on Harmful Tax Practices in the context of the work on Action 5 requires the compulsory spontaneous exchange of information in respect of rulings that could give rise to BEPS concerns in the absence of such exchange," and describing the need for tax administrations to share information gleaned from expanded mandatory disclosure rules as a two-step

The subsequent-change proposal similarly invokes interpretation issues, particularly since discretion is a threshold to implementation. The likelihood arises that this provision is meant to encourage second thoughts by treaty partners rather than to be applied in fact. Given the dramatic impact of triggering the kill-switch, notification and negotiation to forestall such an event are to be expected. While the proposals were largely silent on these issues, the final provisions in the U.S. Model treaty reflect refinement in the approach.[112]

In a sense, this kill-switch resembles the early view of mandatory binding arbitration in the case of mutual agreement procedure failures, and it raises similar issues regarding the expansion of power of competent authorities. Binding arbitration was originally designed and intended to motivate negotiated settlement among competent authorities rather than as a new institution upon which governments expected to rely on for substantive decision-making on tax treaty disputes.[113] The seriousness of consequences and discretionary nature of the subsequent-law change provision suggest that a similar intention may motivate its inclusion in the U.S. Model. If so, this provides additional tools to competent authorities to make decisions without oversight and involvement of lawmakers and without much public scrutiny. Given how much leeway is already exercised by competent authorities in applying international tax law, this expansion of administrative power is noteworthy.[114]

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framework, in which "in the first step some basic information on the ruling and to whom it relates would be provided to another tax authority in accordance with the governing legal instrument; in the second step the receiving tax authority could ask for further information if this was foreseeably relevant to the tax affairs of their taxpayer.").

112. *See supra* discussion at Part I.B., C.

113. *See, e.g.*, Allison Christians, *How Nations Share*, 87 IND. L.J. 1407 (2012) ("[I]nternational tax arbitration is claimed by its designers to be a threat rather than a promise. Its intended role is as a stick to compel competent authorities to come to agreement reasonably and in a timely manner. The prospect of arbitration is meant to 'keep governments honest' in their competent authority dealings with each other. The role of arbitration in international taxation is thus not to independently resolve tax disputes but rather to act as a means of forcing recalcitrant competent authorities to resolve these disputes themselves." (internal citations omitted)).

114. For a discussion of the complex and under-studied role of the competent authority in international tax law, see *id.*

Responding to concerns regarding the proposed language, one official suggested that the U.S. Treasury intended the consequences of violating new Article 28 to be dramatic because reducing a nation's basic tax rate below 15 percent would represent a fundamental tax policy change.[115] The United States may have been signaling an implicit policy against entering into comprehensive tax treaties with countries in which the general individual or corporate tax rate falls below 15 percent.[116] The final versions of the kill-switches, however, provide a more flexible "lower of" standard that would appear to tolerate rates far below 15 percent, conditioned on a prescribed deviation from the "general" rate of no more than 60 percent.[117]

The more flexible standard avoids confronting difficulties posed by setting a global minimum floor of 15 percent. The strict floor contemplated in the proposed provisions could have affected international tax cooperation with many long-standing treaty partners. Ireland—a country that the United States has had a tax treaty with since 1949—serves as an example.[118] The general corporate tax rate on active income in Ireland is currently 12.5 percent,[119] and the country is considering adopting a

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115. Quyen Huynh, Att'y-Advisor, Off. of Int'l Tax Couns., U.S. Dep't of the Treasury, Remarks at Meeting of the American. Bar Association, Sept. 22, 2015 (on file with the author).

116. Since tax treaties are largely motivated by multinational interests, the denial of benefits only to individuals may not impact the willingness of the United States to conclude tax treaties. For a discussion of the motivations that drive the U.S. Treasury to conclude tax treaties, see Christians, *supra* note 4; *The Japanese Tax Treaty and the Sri Lanka Tax Protocol: Hearing Before the S. Comm. on Foreign Relations*, 108th Cong. (2004) (statement of Barbara Angus, International Tax Counsel, Department of the Treasury), http://www.foreign.senate.gov/imo/media/doc/AngusTestimony040225.pdf; Sheppard, *supra* note 31 ("[T]he United States signs commercial agreements and tax treaties with pretty much anyone so that its multinationals can do business more easily. They go in first – it was always understood that the U.S. military protected their commercial interests. If they want a tax treaty, they get one.").

117. *See supra* text accompanying notes 34–36, 46.

118. Convention Between the Government of the United States of America and the Government of Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, Ir.-U.S., July 28, 1997, 2141 U.N.T.S. 167.

119. *Corporation Tax*, REVENUE.IE, http://www.revenue.ie/en/tax/ct/index.html (last visited Aug. 16, 2016). The 12.5 percent rate applies to "trading income," which is generally active business income. Non-trading income (investment income) is subject to a rate of 25 percent. The special-tax regime proposal targets passive income tax rates below 15 percent, and thus would not

6.25 percent rate for profits earned from "knowledge development."[120] Ireland is not the only example. Firms from the United Kingdom that are eligible for patent box treatment would be subject to a central general corporate rate of 10 percent, well below the 15 percent floor.[121]

Other OECD countries including Germany (with a 15.83 percent central general corporate rate), Slovenia (17 percent), Czech Republic, Hungary, and Poland (each at 19 percent) would all be close to the floor.[122] Canada, a high-tax neighbor that has had a treaty relationship with the United States since 1942,[123] has also reduced its general corporate tax rate over the years to the current central government general rate of 15 percent.[124] Gradual reduction of the general corporate tax rate is indeed an OECD-

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affect Ireland. It is not clear, however, whether maintaining a higher rate for investment income would prevent application of the proposed subsequent-change provision.

120. GOV'T OF IRELAND, DEP'T OF FIN., FINANCE BILL 2015: EXPLANATORY MEMORANDUM 7 (2015), http://www.finance.gov.ie/sites/default/files/Finance%20Bill%20Expl.%20Memo%202015.pdf (explaining that a law adopted in late 2015 "introduces a corporation tax relief known as the Knowledge Development Box, in line with the OECD's modified nexus approach to preferential tax regimes. The Knowledge Development Box provides that profits from patented inventions and copyrighted software (qualifying assets) earned by an Irish company can, to the extent it relates to Research and Development (R&D) undertaken by that company, be effectively taxed at a rate of 6.25 per cent.").

121. *Corporation Tax: The Patent Box*, GOV.UK, https://www.gov.uk/guidance/corporation-tax-the-patent-box (last visited Aug. 16, 2016). International Tax Counsel Danielle Rolfes stated that "royalty payments to patent boxes that require substantial activities would be excused from the special regimes sanction," and that the U.S. Treasury may adopt the OECD nexus-based test "if we like it." Sheppard, *supra* note 31. For the OECD test, see ACTION 5 FINAL REPORT, *supra* note 42, at 9 (explaining that the nexus approach "allows a taxpayer to benefit from an IP regime only to the extent that the taxpayer itself incurred qualifying research and development (R&D) expenditures that gave rise to the IP income.").

122. *OECD Tax Database*, OECD.ORG, http://www.oecd.org/tax/tax-policy/tax-database.htm#C_CorporateCaptial (last visited Aug. 6, 2016) (Table II.1, corporate and capital income tax).

123. Convention Between Canada and the United States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion in the Case of Income Taxes, Can.-U.S., Mar. 4, 1942, 56 Stat. 1399.

124. *OECD Tax Database*, *supra* note 122. Combined with provincial rates, the average tax rate is 26.3 percent. It is not clear how subnational tax rates would factor into the identification of a lowered corporate tax rate under the subsequent-change proposal.

wide phenomenon.[125] Inclusion of a strict floor in the U.S. Model might have been a significant development.

Perhaps such a development would have been appropriate. A reduction in general tax rates below 15 percent instead might signal that a treaty partner is more appropriately a tax information exchange agreement (TIEA) partner instead—which would indicate that the United States would want to obtain information from that country rather than grant its residents a tax reduction. Normally, a significant change in policy would warrant treaty renegotiation, but the U.S. Treasury might wish to avoid this result, especially if there are domestic political obstacles to treaty ratification (as has been the case for the past several years).[126] While TIEAs are arguably easier to accomplish in terms of internal ratification procedures, countries that long have had a comprehensive tax treaty relationship with the United States might be unwilling to reduce the relationship to one only involving information exchange.[127]

CONCLUSION

Introduced as a blanket U.S. policy to prevent general tax treaty abuse, kill-switches highlight a real-time policing function in U.S. tax treaties, explicitly constructing reflexive responses to certain forms of tax competition. Even if meant to prevent other problems, embedding a kill-switch in a treaty raises multiple international and domestic law issues. The use of such provisions creates distinct legal, procedural, and political pressures in the tax-treaty relationship that implicate treaty negotiation, ratification, interpretation, and dispute resolution. Kill-switches also communicate a defensive tenor in the tax treaty relationships among many countries. Their introduction in the U.S. Model reflects the steady deterioration of tax treaties

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125. ORG. FOR ECON. CO-OPERATION & DEV. [OECD], TAX REFORM TRENDS IN OECD COUNTRIES (2011) ("The trend towards a reduction of corporate income tax rates started with the tax reforms in the United Kingdom and the United States in the mid-1980s which broadened the tax base (e.g. by making depreciation allowances for tax purposes less generous) and cut statutory rates. Corporation tax rates have continued to be cut in recent years."); *see also OECD Tax Database*, *supra* note 122.

126. *See supra* note 110.

127. For a brief overview of the ratification process for TIEAs as opposed to tax treaties, see Allison Christians, *The Dubious Legal Pedigree of IGAs (and Why It Matters)*, 69 TAX NOTES INT'L 565 (2013).

from essentially diplomatic documents premised on the good faith of the parties to detailed contracts drafted in anticipation of the opposite.

The kill-switch has been a relatively rare, if not interesting, feature in the international tax landscape. Its inclusion in the U.S. Model Tax treaty may make it a recurring feature and bring some attention to it by administrators, jurists, and scholars. There is limited but directly relevant contemporary precedent for this function, so far with little discussion or controversy in global discourse. That may be due to inattention owing to infrequency of use. At minimum, the provisions express some version of the single tax principle and involve monitoring and peer pressure more overtly than has been seen in the past. This might not signal a wholly new vision for tax treaties, but it does seem to reflect a shift in how willing the United States is to mandate minimal tax standards in its treaties.