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Global tax environment

The Changing Tax Landscape

- Tax Morality
- Transfer Pricing
- CFC
- Codes of Conduct
- Beneficial Ownership
- BEPS
- Lux Leaks
- Permanent Establishments
- Tax Rulings

- General anti avoidance rules
- CCCTB
- FATCA
- Panama Papers
- Hybrids
- State Aid
- Mandatory Disclosure
- Tax Treaties
- Directors' Compliance Statements

The impetus for change

Governments under fiscal pressure as a consequence of the global economic crisis

Austerity measures prompted a ‘fairness’ and ‘tax morality’ debate: “Is everyone paying their fair share in society?”

Increased public and media focus on tax practices of multinationals

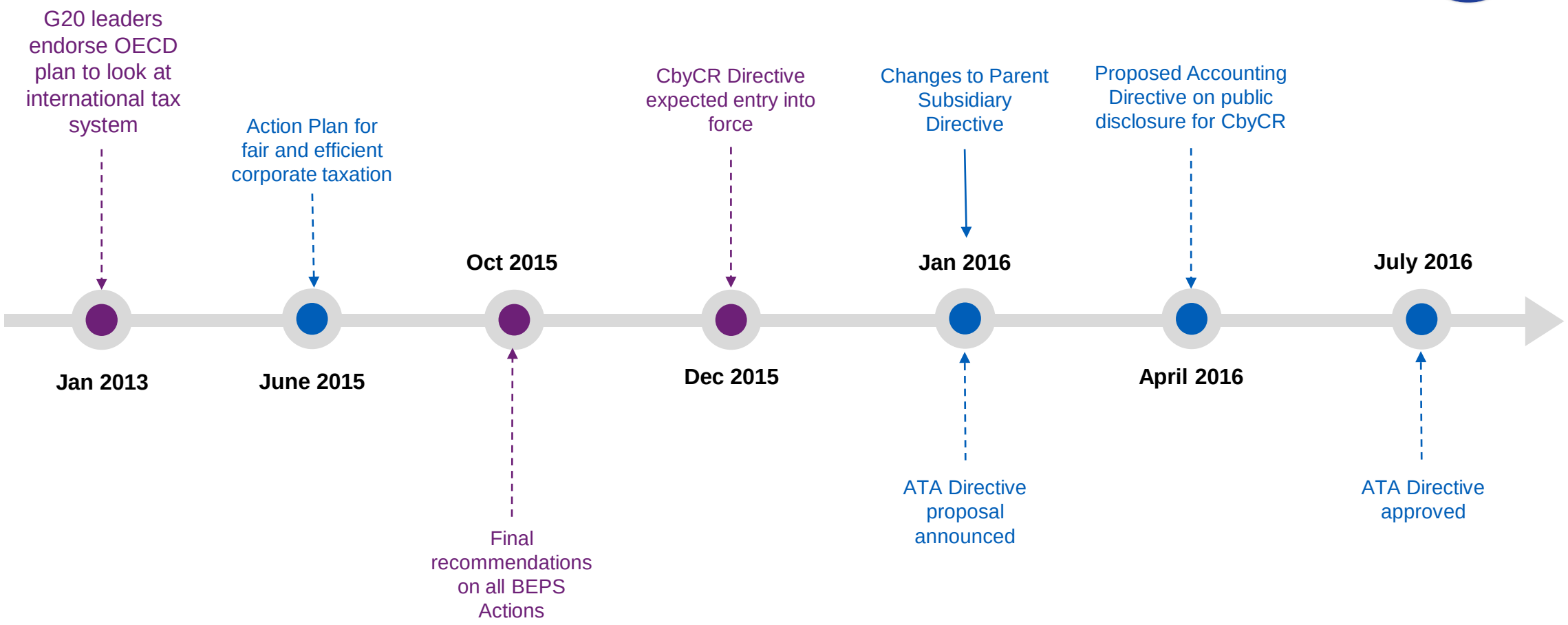
Policy concern that international tax rules are outdated and do not adequately address modern business models in the digital age

G20 reinforced political concerns and endorsed collaborative efforts to modernise international rules and standards

Lux leaks, Panama papers, etc.

State aid concerns

Developments - BEPS & EU



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Base Erosion and Profit Shifting ("BEPS")

BEPS - where are we?

- Action 1 – Digital Economy
- Action 2 – Hybrid Mismatches
- Action 3 – CFC Rules
- Action 4 – Interest Deductions
- Action 5 – Harmful Tax Practices
- Action 6 – Tax Treaties
- Action 7 – Permanent Establishment
- Action 8-10 Transfer Pricing
- Action 11 – BEPS Data
- Action 12 – Mandatory Disclosure
- Action 13 – Country-by-Country Reporting
- Action 14 – Dispute Resolution
- Action 15 – Multilateral Instruments

Key Action Plans affecting leasing industry

Action 2 – Hybrid Mismatches

Action 4 – Interest Deductions

Action 6 – Tax Treaties

Action 7 – Permanent Establishment

Action 13 – Country by Country Reporting ("CbyC")

Action 2 - Hybrid Mismatches

- Focuses on the use of hybrid instruments or entities to create mismatches in treatment.

- Two main types:
  - Instruments which create a deduction in one jurisdiction with no corresponding taxable income in the other jurisdiction.
  - Instruments which create a double deduction for a payment.

- Indirect mismatches may also exist, e.g. hybrids used further up in chain of transactions.

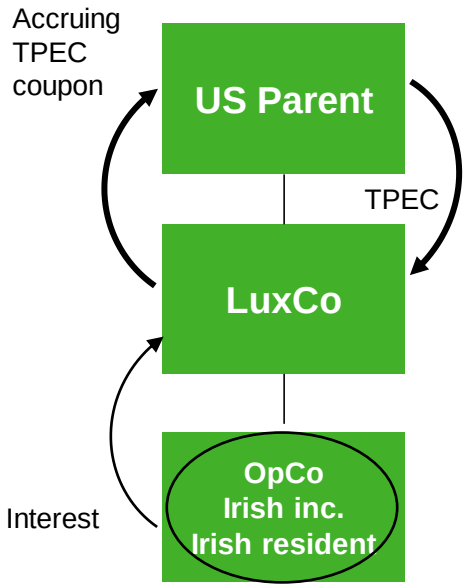
- Seeks to align tax treatment of instrument or entity with tax outcome in counterparty jurisdiction:
  - Deny tax deduction if payment not subject to tax in recipient country
  - Deny one deduction for double deduction outcomes

- Financing structures relying on hybrid mismatches to reduce foreign taxes likely to see benefits eroding in future.

- Treaty measures relating to dual residents, hybrid entities and branches

Action 2 - Hybrid Mismatches

- Example
  - TPECs are treated as equity instruments for US tax purposes. US taxable income from the TPECs generally only arises when an actual payment is made. US parent can also claim tax credit relief for underlying tax credits related to the TPEC 'dividend', if any. However, the TPEC is treated as a debt for Luxembourg tax purposes and coupons are deductible on an accruals basis.
  - Action 2 will seek to address such situations by denying an interest deduction at the LuxCo level.

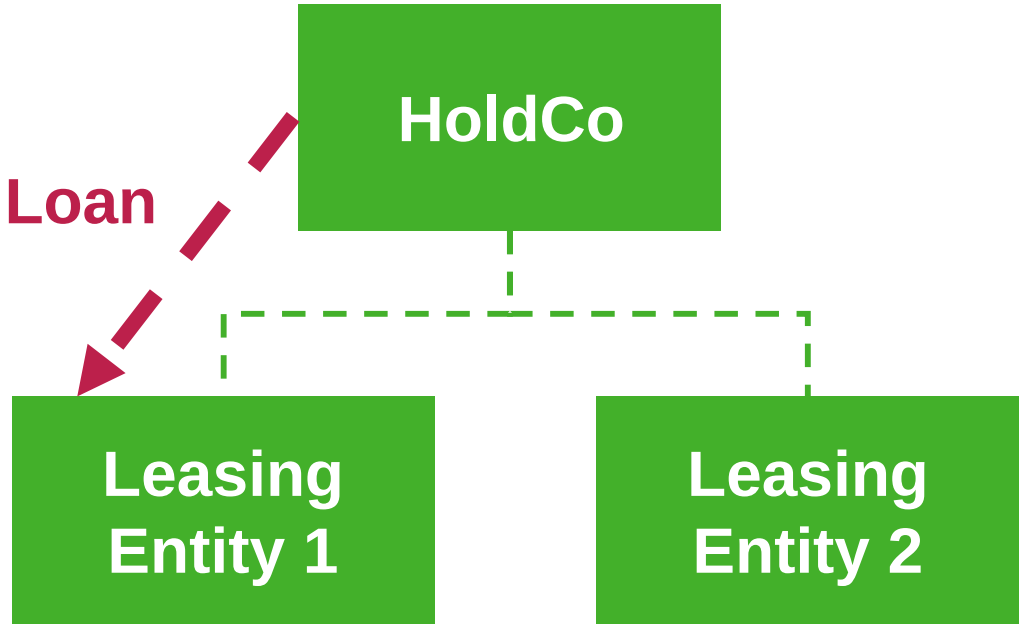


Action 4 - Interest Deductions

- Prevent base erosion through funding structures by limiting tax deduction for interest.
- Recommends limiting a deduction for an entity's net interest expense to a percentage of EBITDA
  - Fixed ratio corridor of 10%-30% of EBITDA.
  - Group ratio for highly-leveraged groups – allow a 10% uplift on group's net third party interest expense.
- Targeted anti-avoidance
- De minimus threshold
- Carry forward/back unused interest
- Member States have differing views on this Action. More work is required on the design and operation of the group ratio rule as no country operates an EBITDA group ratio.

Action 4 - Interest Deductions

- Example
  - HoldCo is resident in Country A.
  - Leasing Entity 1 is resident in Country B.
  - Country B limits interest deductions to 30% of EBITDA.
  - HoldCo provides a loan to Leasing Entity 1 to acquire an aircraft.
  - Leasing Entity 1 has EBITDA of €5m, with interest payments to HoldCo of €4m.
  - €4m = 80% of €5m.
  - Deduction allowed to Leasing Entity 1 is limited to €1.5m (i.e. 30% of €5m).



Action 6 - Tax Treaties

- Focuses on new approach to address tax treaty shopping arrangements.
  - **Limitation on benefits clause** ("LOB") which focuses on ownership, base erosion and complexity. Often criticised for its complexity.
  - **Principal purposes test** ("PPT") which focuses on whether one of the main purposes is accessing tax treaty. Often criticised for its uncertainty.

- Proposed measures include:
  - Clear statement not to avoid tax
  - Simplified LOB with PPT
  - Detailed LOB with anti-conduit measures
  - PPT

- Suggested specific anti-abuse rules for certain transactions

- Work ongoing to finalise wording of LOB clause (to be aligned with now finalised US model treaty).

- Implementation through country choices and Multilateral Instrument.

Action 6 - Tax Treaties

- Tax treaty access is critically important for aircraft lessors:
  - Direct leases
  - LILOs
  - Orphan structures
  - Securitisations

- Emphasis on commercial purpose – focus on structure and substance.

- Complexity as every country will interpret rules in their own way.

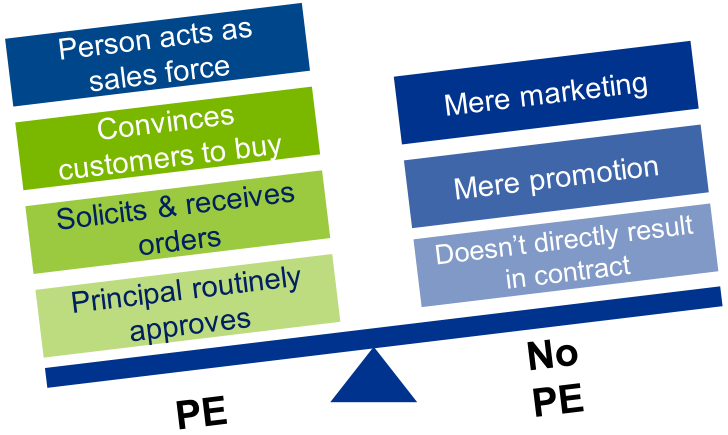
- 'EU compliant' recommended PPT preserves treaty benefits if the transaction "*reflects a genuine economic activity*".
  - Improvement on the OECD draft but still highly subjective.
  - Unclear what will happy if non-EU counterparty to a tax treaty chooses LOB or LOB/PPT combination under the Multilateral Instrument.

Action 7 – Permanent Establishment ("PE")

- Focuses on activities which will create a PE in a foreign jurisdiction.

- Three issues specifically addressed:
  - Dependent Agent Standard
  - Preparatory and Auxiliary Activities
  - Splitting Contracts

- Dependent Agent Standard
  - Replaces "conclusion of contracts" and "in the name of" with broader standards.
  - Independent agent exception cannot apply where agent acts exclusively for connected persons
  - Broadens "conclusion of contracts" to include "habitually play principal role in leading to conclusion of contracts without material modification".

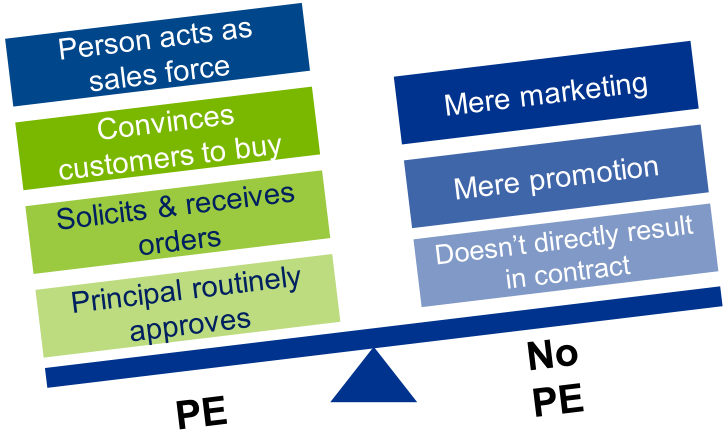


Action 7 - Permanent Establishment ("PE")

- Preparatory and Auxiliary Activities – addresses concern over abuse of specific activity exemptions by:
  - Subjecting all specific activity exemptions to an overall "preparatory and auxiliary" condition; or
  - Retaining existing exemptions so long as the "anti-fragmentation rule" is adopted (grouping of connected enterprises).

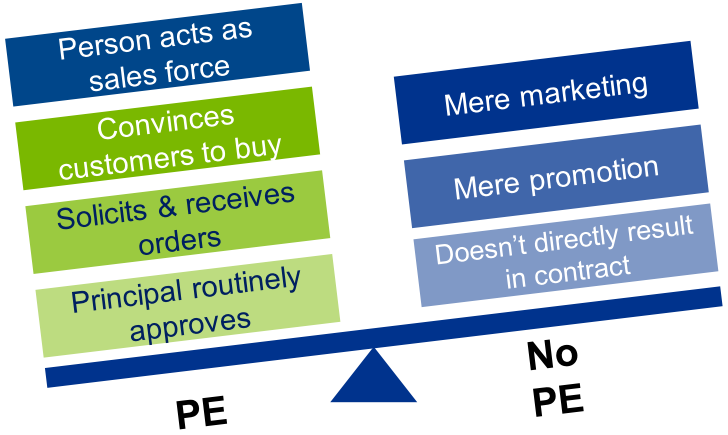
- Splitting Contracts
  - Addresses installation, construction and service PEs.
  - No specific rule in Article 5 of the model treaty; instead relies on proposed principal purposes test
  - Unlikely to be relevant to the leasing sector.

- PE language / profit attribution to be refined and guidance issued in 2016.



Action 7 - Permanent Establishment ("PE")

- Impact on leasing sector
  - Potentially very significant for leasing groups which have people travelling internationally and involved in buying, selling and leasing aircraft.
  - The changes are targeted at commissionaire structures and on the ground teams which negotiate the terms of contracts but which do not formally conclude contracts for the non-resident.
  - Key issue for leasing sector given the fact that senior executives/ marketing personnel regularly visit local customers to discuss contract terms. It will therefore be important to carefully review evidence of 'head office' decision making on final contracts – head office needs to do more than merely 'rubber stamp' the final contract terms.
  - Review local market sales support and marketing activity as these may 'lead to the conclusion of contracts'.



Action 13 - CbyC Reporting

- Reporting of global allocation of sales, profits, employees, taxes and other metrics
- Applies to:
  - Groups with turnover of €750m+
  - Accounting periods commencing after 1 January 2016
- Reports must be filed with Tax Authorities within 12 months of year end.
- Automatic sharing of report between Tax Authorities in countries that group operates (where exchange agreement in place).
- EU Member States introducing legislation to accommodate data sharing. Some, including Ireland already adopted CbyC measures.
- Implications on transfer pricing policies & global tax allocation
- Data collection challenges

Final CbyC Template (Numerical Disclosures)

CbyC Template – Page 1

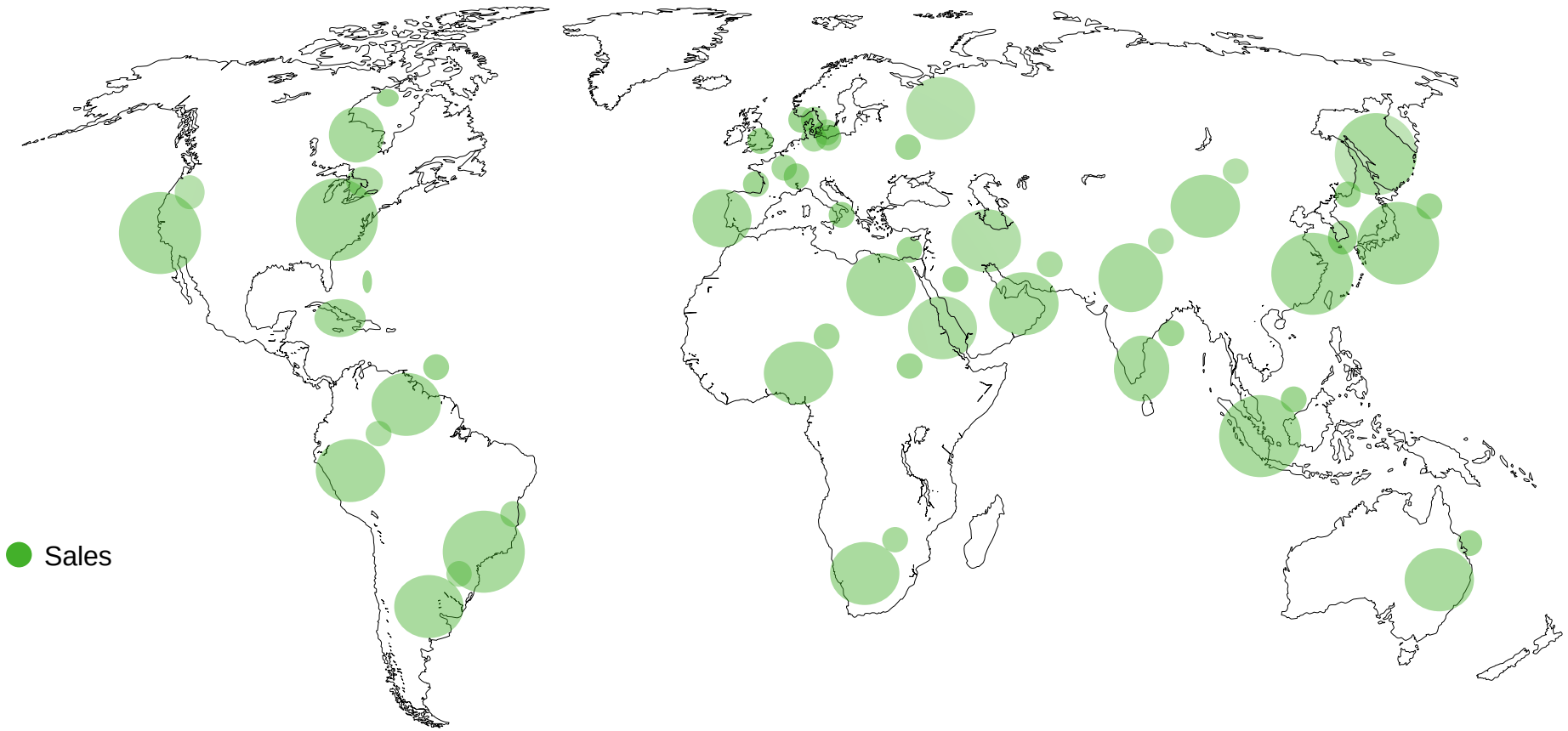
Tax Jurisdiction	Revenue			Profit (loss) before income tax	Income tax paid (on a cash basis)	Income tax accrued – current year	Stated Capital	Accumulated Earnings	Number of employees	Tangible assets other than Cash and Cash Equivalents
	Unrelated Party	Related Party	Total							
Country A	✘	✘	✘	✘	✘	✘	✘	✘	✘	✘
Country B	✘	✘	✘	✘	✘	✘	✘	✘	✘	✘
Not resident in any tax jurisdiction	✘	✘	✘	✘	✘	✘	✘	✘	✘	✘

Final CbyC Template (Business Activity Disclosures)

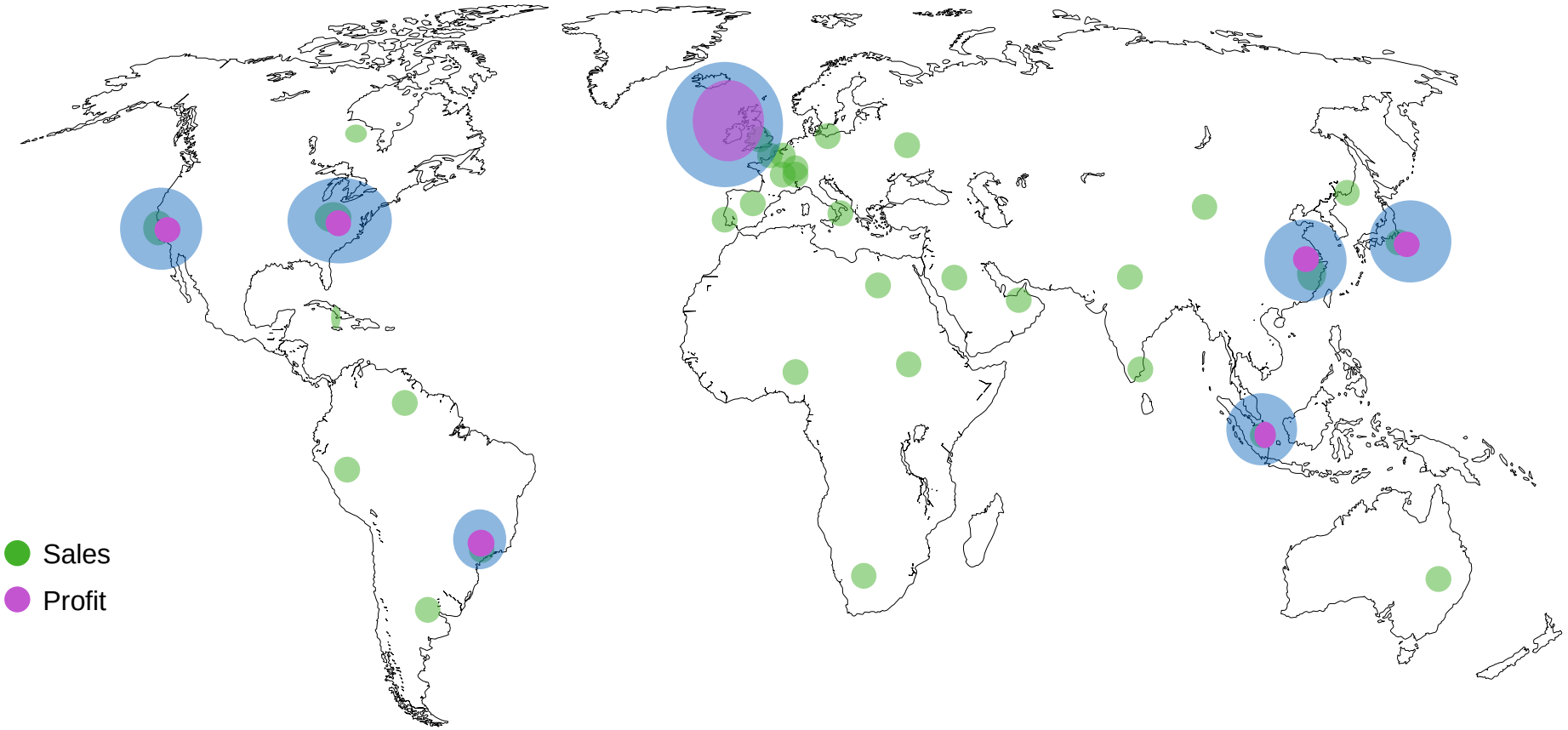
CbyC Template – Page 2

Tax Jurisdiction	Constituent entities resident in the tax jurisdiction	Tax jurisdiction of organisation or incorporation if different from tax jurisdiction of residence	Example Activities					
			Sales, marketing or distribution	Purchasing or procurement	Technical	Support services	Internal group finance	Other
Country A	Service Co A		✓		✓	✓	✓	
	Lease Co A	Country B		✓				✓
Country B	Service Co B		✓		✓			
Country C	Service Co C		✓		✓	✓		
Country D	Finance Co D						✓	

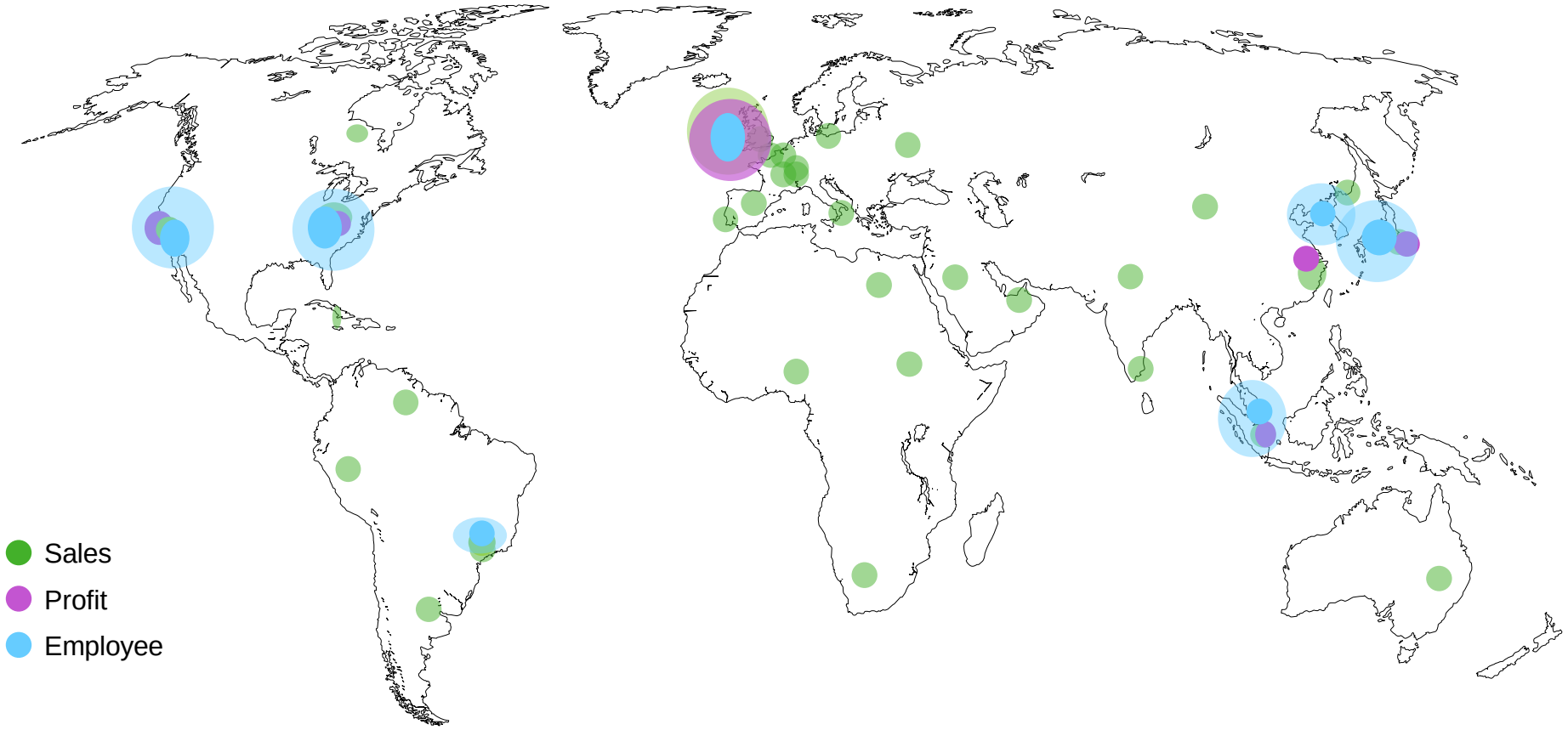
Action 13 - CbyC Reporting



Action 13 - CbyC Reporting



Action 13 - CbyC Reporting



Action 15 - Multilateral Instrument ("MLI")

- Developing a Multilateral Instrument ("MLI") to modify bilateral tax treaties.
- MLI seeks to implement agreed treaty measures in a reasonably short time frame while preserving the bilateral nature of tax treaties.
- Aim of finalising the MLI and to open it for signature by 31 December 2016.
- Participation in the development of the MLI is voluntary and does not entail any commitments to sign up to the instrument, but the OECD treaty measures are Minimum Standard, signalling strong political commitment.
- Will be the driver for changes recommended under Treaty and PE actions.
- Not clear yet what exact form the MLI will take and what level of optionality will be available to those countries which sign up.
- EU recommendation in January 2016 package of measures, endorsed by the EC in May that EU Member States make harmonised choices under MLI of 'EU compliant' PPT (treaty anti-abuse measure) together with common anti-abuse measures for branches and common PE standard.

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EU Anti-Tax Avoidance Directive

ATA Directive - what is it?

- The EU has approved an Anti-Tax Avoidance Directive that will apply across all EU Member States:
  - Proposal first announced by EU Commission on 28 January 2016
  - Formal approval on 12 July 2016
  - Implementation scheduled to commence from 2019
  - Deferral of some measures to 2020 and 2024.

- The Directive is a separate and distinct initiative from the OECD's BEPS plans BUT is designed to further build on the proposals announced as part of the BEPS initiative.

- The EC's ambition is to harmonise to the greatest extent the adoption of anti BEPS measures into local laws across EU Member States.

- Given the complexity and range of measures, it is understood that the **Department of Finance plans to hold a consultation on Ireland's implementation of the Directive** measures – no details as yet as to structure or timing of the consultation.

OECD BEPS vs EU Response

BEPS Actions	EU Response
Action 1 - Digital Economy	Focus not on BEPS but on removing barriers to growth and on VAT. European strategy on Digital Economy – 16 target initiatives by end of 2016 to exploit growth opportunities (May 2015)
Action 2 - Hybrid Mismatches	Included in Article 9 of ATA Directive. Measures also included in changes to Parent Subsidiary Directive
Action 3 - CFC Rules	Included in Article 7 & 8 of ATA Directive
Action 4 - Interest Deductions	Included in Article 4 of ATA Directive. Possible to defer implementation to 2024
Action 5 – Harmful Tax regimes	ECOFIN adopted an amended DAC (DAC 3) for automatic exchange of EU rulings to be implemented by MS by December 2016
Action 6 – Tax treaty abuse	Included in package of measures announced in January 2016
Action 7 – PE's	Included in package of measures announced in January 2016
Action 8-10 – Transfer Pricing	EU Transfer Pricing forum working on EU approach
Action 11 – BEPS Data	EU Tax policy recommendations require MS to conduct cost/benefit analysis. EU study underway on impact of some aggressive tax planning
Action 12 – Mandatory Disclosure	May 2016 announcement that EC to develop proposals for EU Mandatory Disclosure
Action 13 – TP Documentation & CbyC	EU CbyC reporting in DAC 4 – to take effect for accounting periods beginning on or after 1 January 2016
Action 14 – Dispute Resolution	EU Arbitration Convention Consultation launched Feb - May 2016. EU presidency indicates development of EU proposals by November 2016
Action 15 – Multilateral Instrument	EU Compliant measures agreed
	Exit Taxation
	EU GAAR

Key Concepts

Interest Restriction

Hybrid Mismatches

Exit Charge

Controlled Foreign Company Rule (CFC)

General Anti- Abuse Rule (GAAR)

- **Implementation with effect from 1 January 2019 (with some exceptions)**
- **Minimum Standard**

Interest Restriction

- **Deduction for net borrowing costs capped at 30% of EBITDA**
- **Borrowing costs: Interest and economic equivalent to interest as defined under national law**
- **Applies to "Net" borrowing costs**
- **Tax measure of EBITDA**

Profit-participating loans	Imputed interest (convertible bonds, zero coupon bonds)
Finance leases	Sharia finance
Capitalised interest	Amortised interest
Transfer priced interest	Notional interest (derivatives or hedges on borrowings)
FX movements on interest	Guarantee fees & Arrangement Fees

Interest Restriction

Permitted Exclusions

Net Interest ≤€3 million

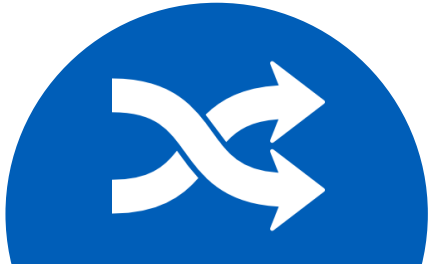
Standalone Entities

Pre 17 June 2016 Loans

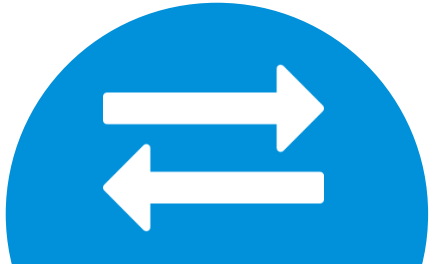
Long-term Public Infrastructure

Interest Restriction

Optional Tax Group Level Test



Taxpayer entity in Consolidated Tax Group



Entities in Non-Consolidated Tax Groups

Interest Restriction

Group Ratio Rule

Raise cap to same ratio as group's interest on third-party borrowing to EBITDA

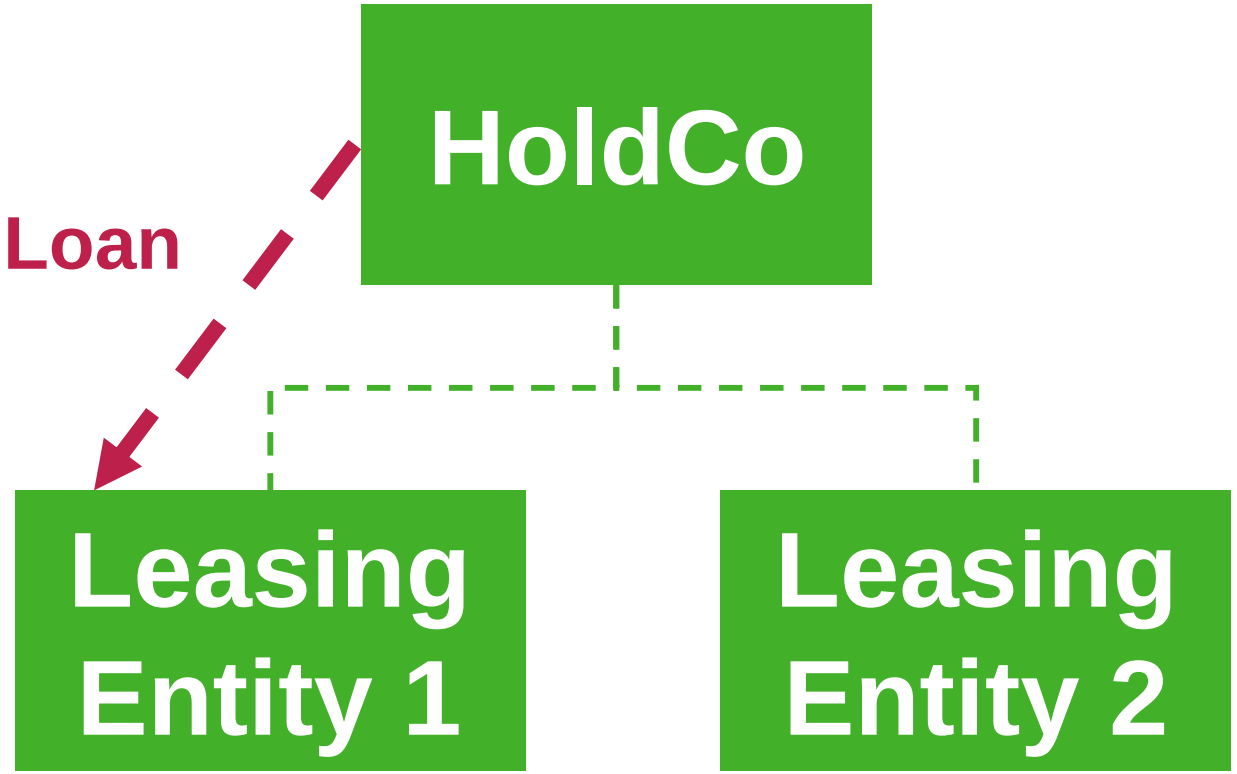
Borrower's equity-to-assets ratio ≥ group ratio

2% leeway

Financial statements valuation methodology

Interest Restriction

Example 1



EBITDA: €5,000,000

Interest: €2,000,000

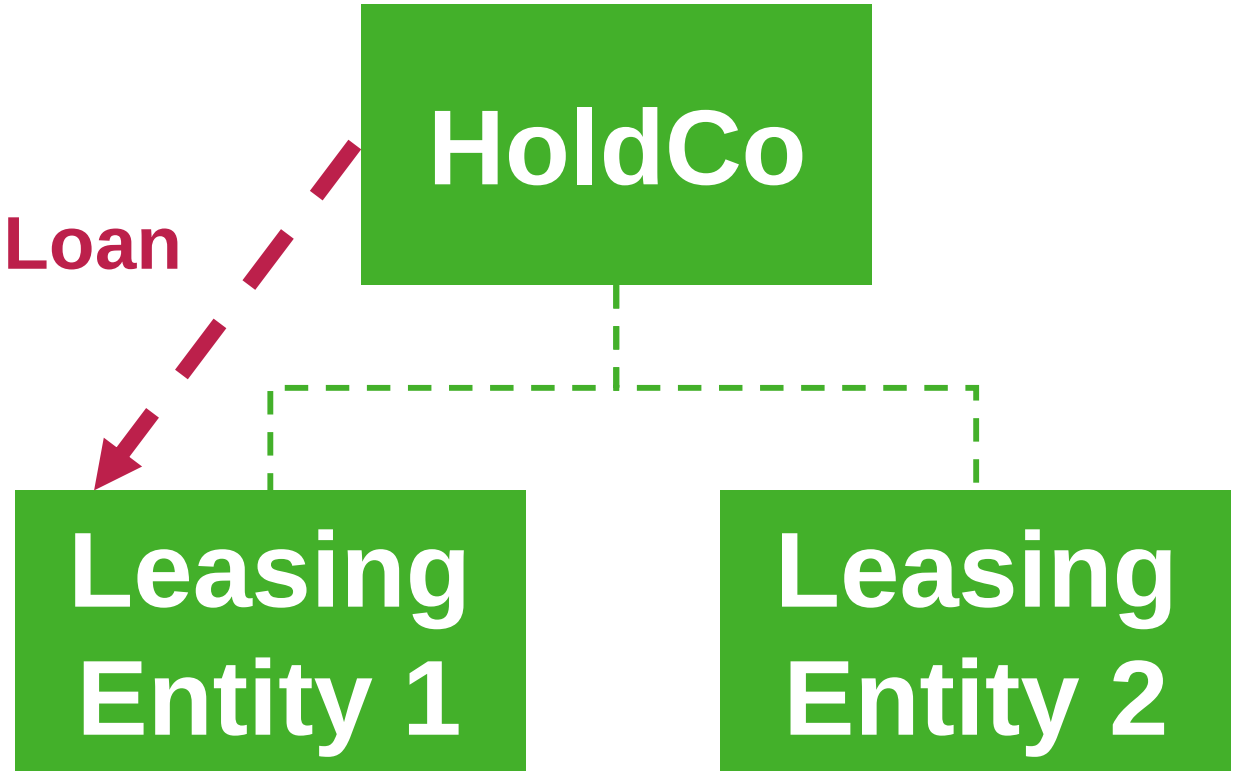
Ratio: 40%

BUT… Total Interest < €3,000,000

Result: No Restriction

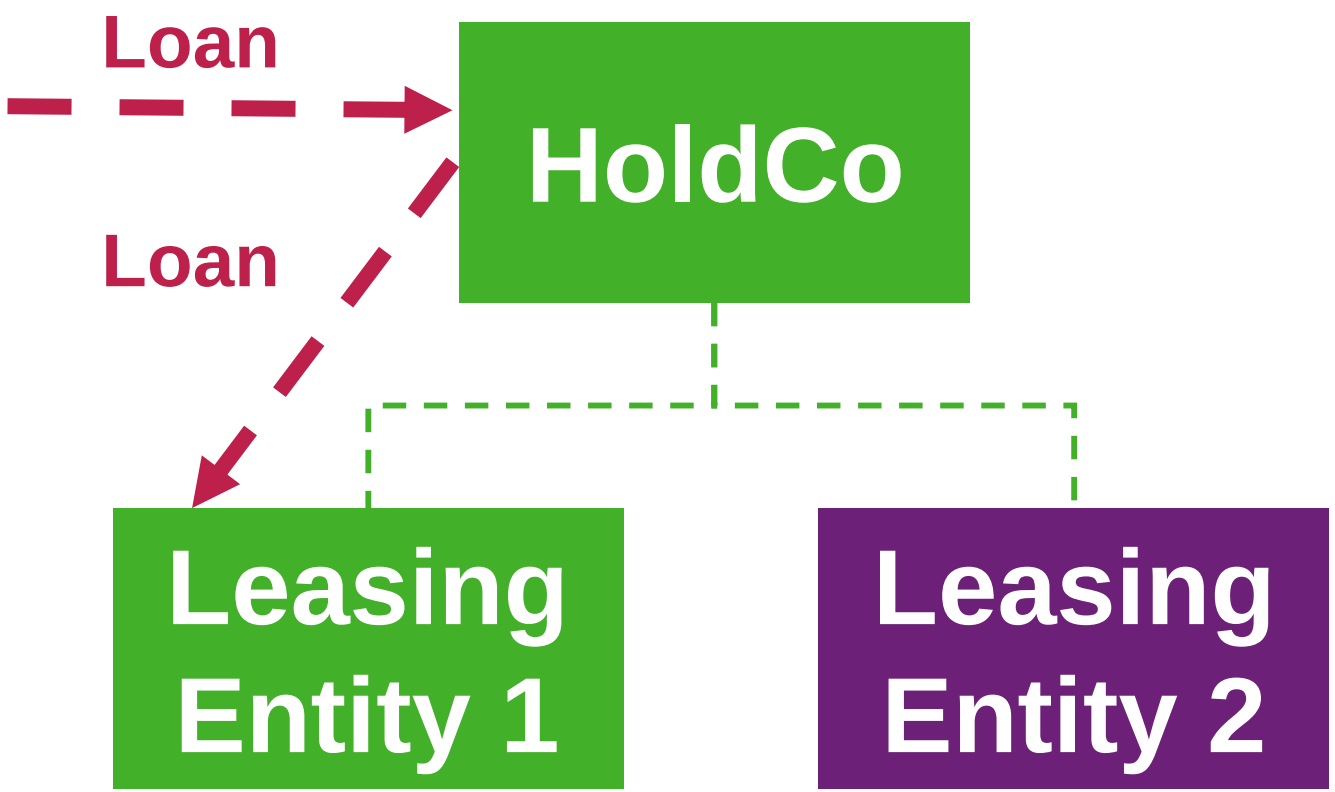
Interest Restriction

Example 2



EBITDA:	**€50,000,000**
Interest:	**€20,000,000**
Ratio:	**40%**
BUT…	**Leasing Entity 2 EBITDA = €25,000,000** **Total EBITDA = €75,000,000**
Tax Group Ratio:	**27%**
Result:	**No Restriction**

Interest Restriction



Example 3

EBITDA: €50,000,000

Interest: €20,000,000

Ratio: 40%

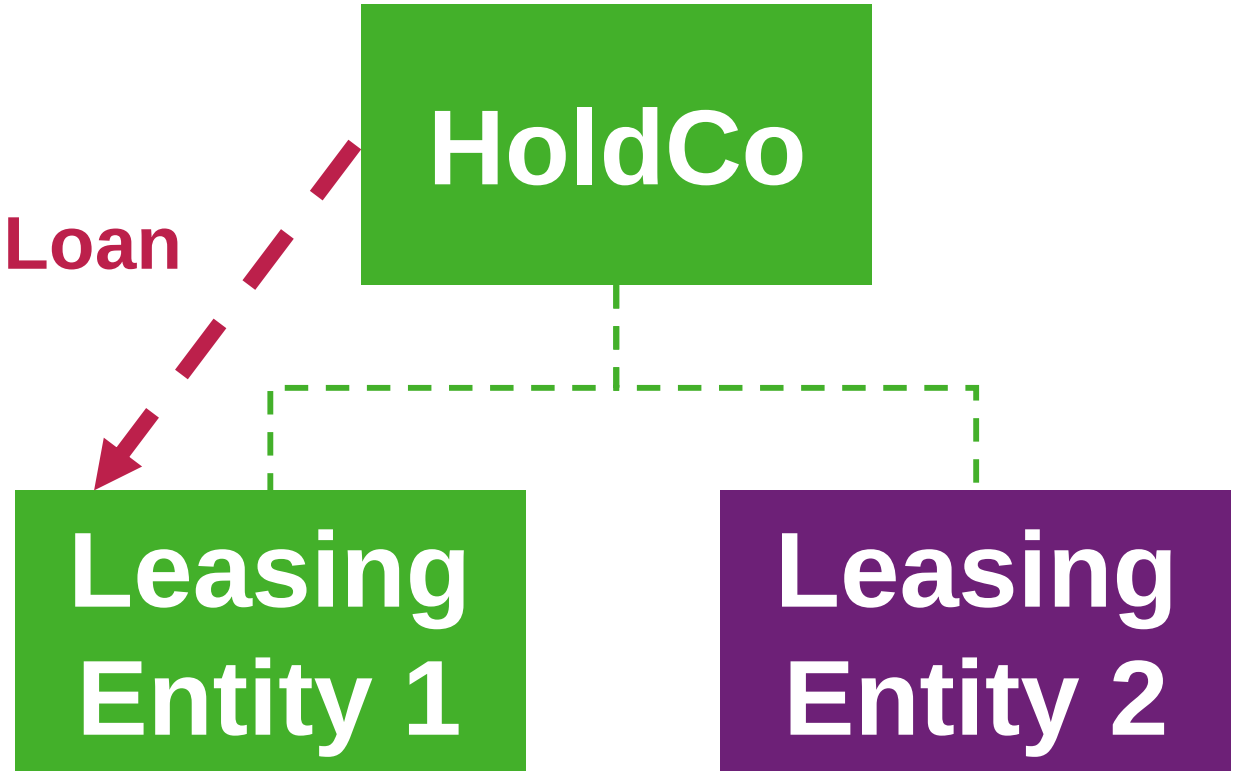
BUT… Leasing Entity 2 EBITDA: €25,000,000
Group Consolidated Accounting EBITDA: €75,000,000
Group 3rd Party Interest: €27,000,000

Consolidated Group Accounting Ratio: 36%

Result: Deductive interest capped at 36% of local taxable EBITDA = €18,000,000

Interest Restriction

Example 4



EBITDA:	**€50,000,000**
Interest:	**€20,000,000**
Ratio:	**40%**
BUT…	**Leasing Entity 1 Equity-to-Assets: 1:3**
	Group Consolidated Accounting Equity-to-Assets: 1:4
Result:	**No Restriction**

Interest Restriction

Member State option to allow

Carry forward (indefinitely) unused deductions

Carry forward (indefinitely) unused deductions or back (3 years)

Carry forward (indefinitely) unused deductions and unused interest capacity (5 years)

Interest Restriction

Optional exemption for financial undertakings

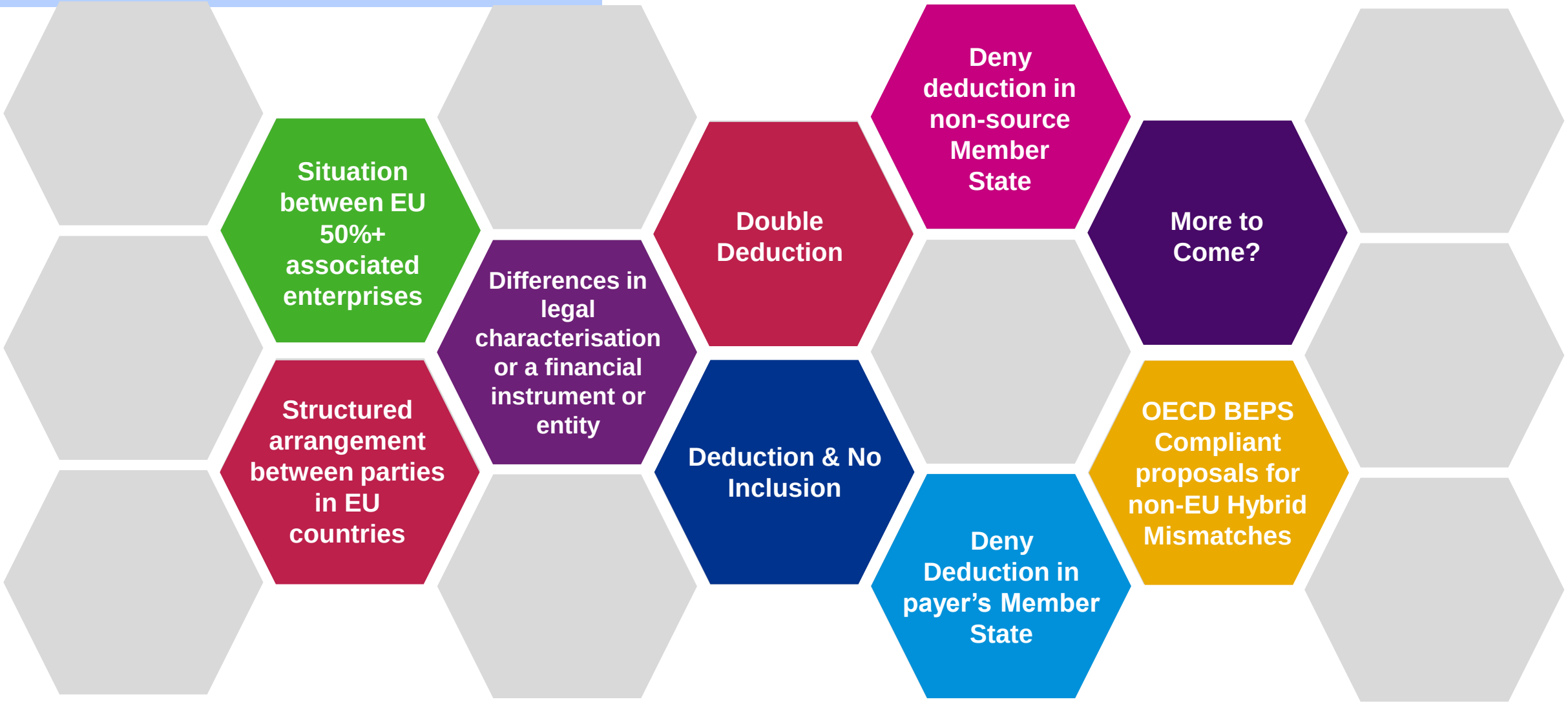
- Credit Institutions (banks)
- Insurance/Reinsurance companies
- Occupational retirement pension funds
- EU social security pension schemes
- AIFMs. AIFs managed by AIFMs, Supervised AIFs
- UCITS funds
- OTC derivative counterparties

Interest Restriction

Effective
1 January 2019

Possible Deferral to
1 January 2024

Hybrid Mismatches

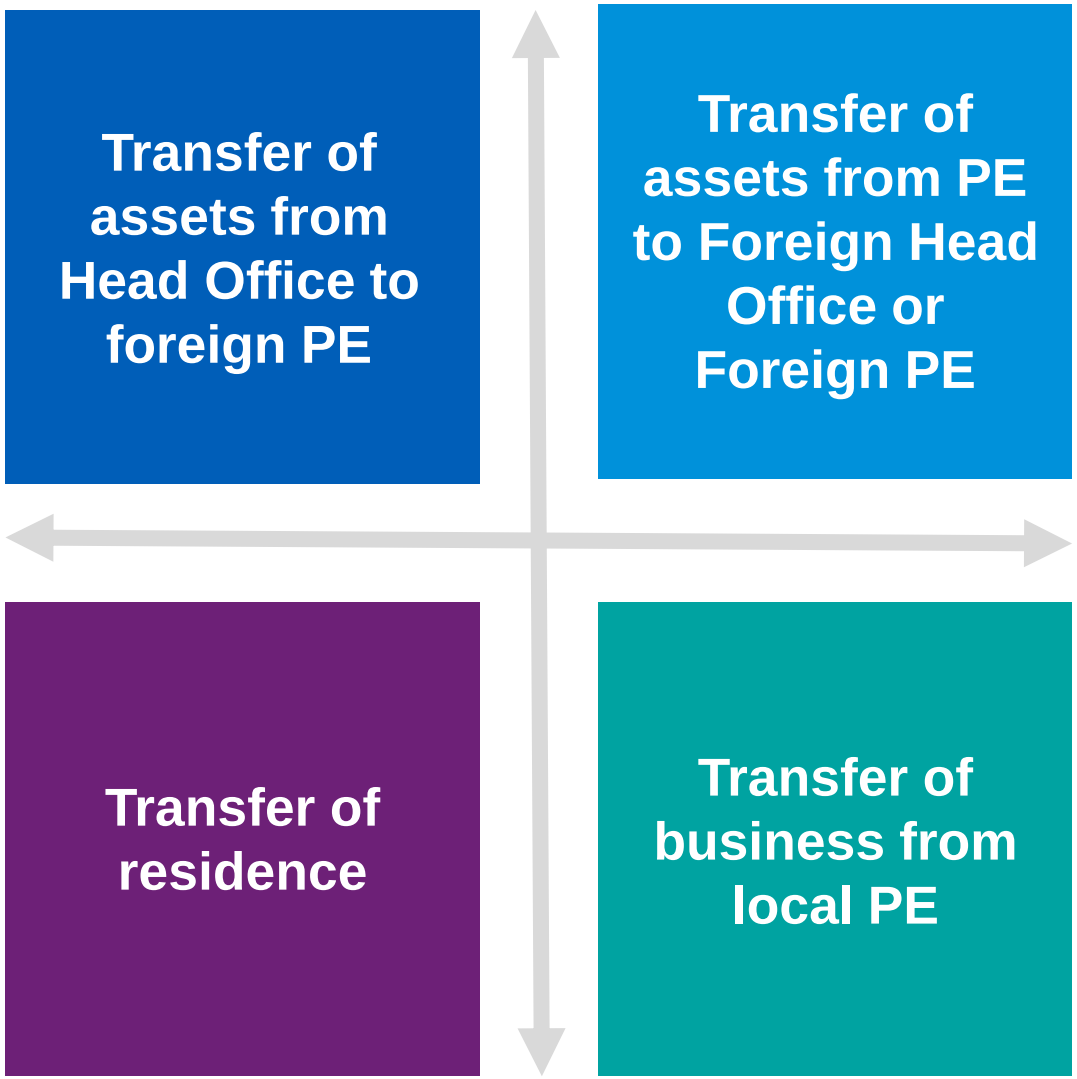


Exit Charge

Deemed disposal at market value where Member State loses taxing rights as a result of:

Exclusion for <12 month transfer for:

- **Financing of securities**
- **Collateral**
- **Prudential capital requirements**
- **Liquidity management**



Exit Charge

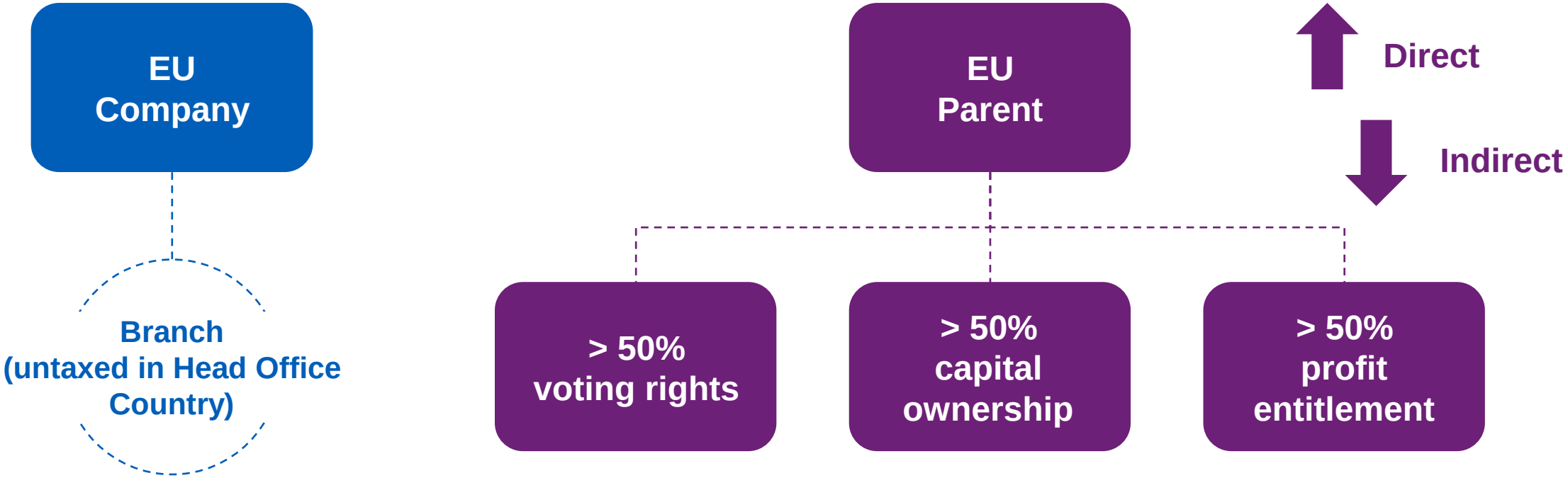
Re-basing of Assets in Acquirer's Member State

EU / EEA
5 Year Instalment Plan

Option to Defer Implementation until 2020

Controlled Foreign Company (CFC) Rule

Parent / Head-Office Pays Tax on Undistributed Income & Gains of Branch / Subsidiary



Controlled Foreign Company (CFC) Rule

CFC Tax

<50%

Parent / Head Office Tax

Black, White, & Grey Lists?

Controlled Foreign Company (CFC) Rule

What Income & Gains are caught?

Controlled Foreign Company (CFC) Rule

Category Approach – NON DISTRIBUTED

- Interest & income from financial assets
- Royalties & IP Income
- Dividends
- Gains on shares
- Finance lease income
- Insurance, banking and financial activity profits
- Limited-risk distribution / commissionaire profits

Controlled Foreign Company (CFC) Rule

Category Approach

Do not apply if demonstrates:

Carries on substantive economic activity

Supported by: Staff, equipment, assets, premises

BUT…

Option to Disapply "Substance Exception" for non-EEA Member States

Controlled Foreign Company (CFC) Rule

Optional Exclusions (Category Approach)

≤1/3 total income is from specified categories

**Financial Undertakings*
≤1/3 income in specified categories from Head Office or 25%+ associates**

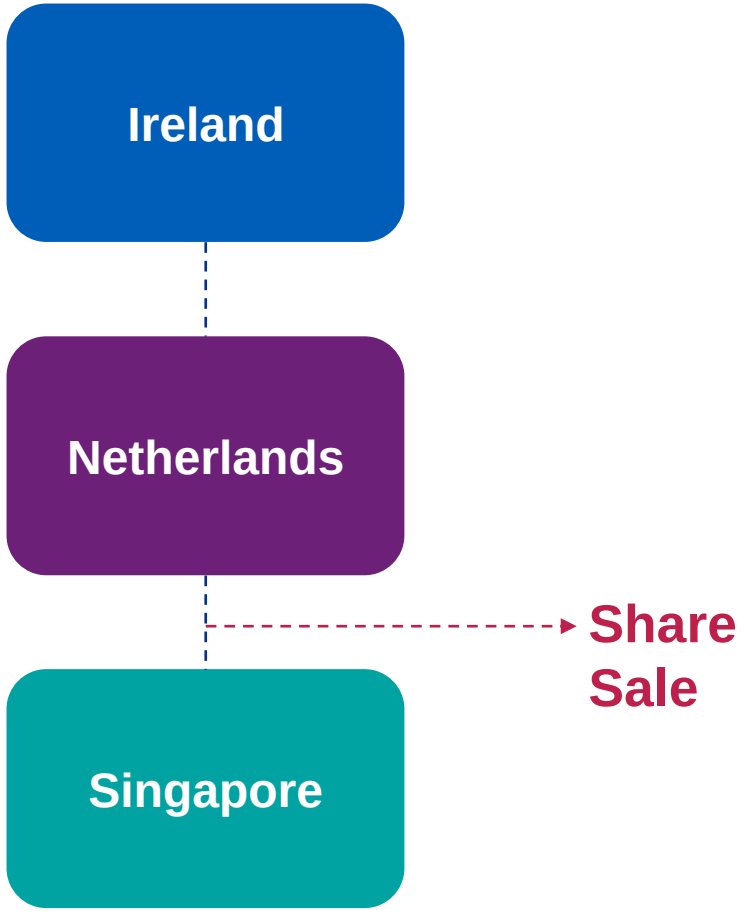
***Credit institutions | Insurance / reinsurance companies | Occupational retirement pension funds | EU social security pension schemes | AIFMs | AIFs | UCITS funds | OTC derivative counterparties**

Controlled Foreign Company (CFC) Rule

Example 1

- Netherlands sells Singapore
- Netherlands exempts gain
- Netherlands does not distribute
- Share sale would be taxable in Ireland
- Result: Irish CFC Charge on Gain

<u>Unless</u>: Exception Applies (e.g. substantial economic activity)

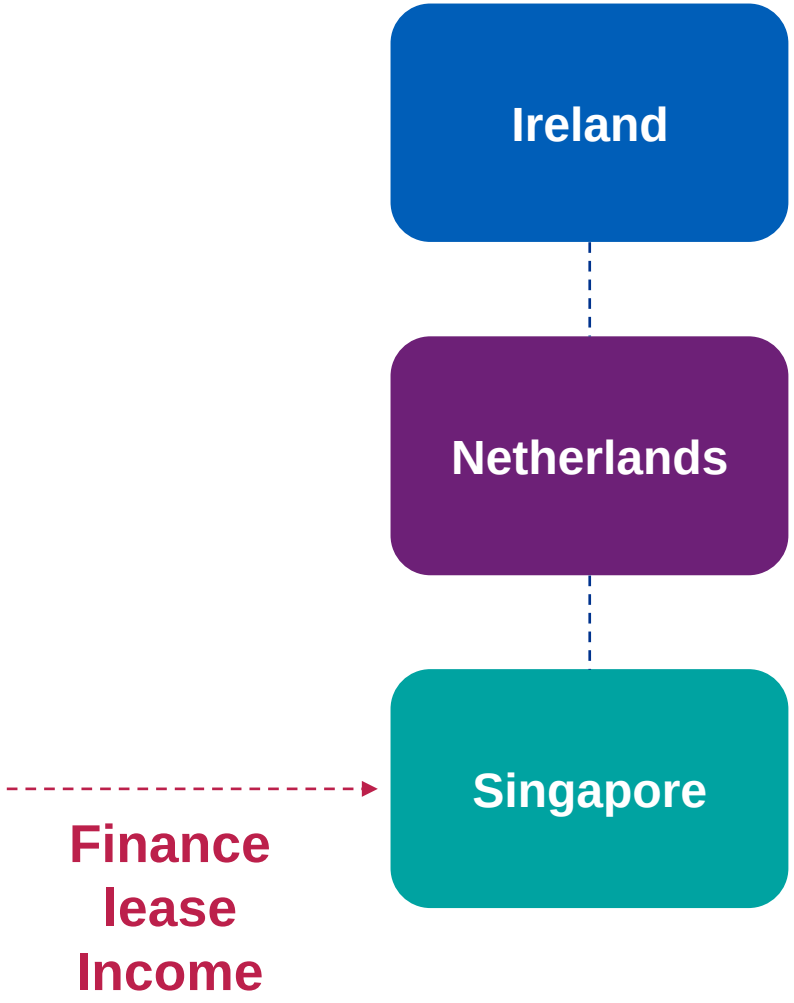


Controlled Foreign Company (CFC) Rule

Example 2

- ► Singapore earns finance lease income
- ► Singapore does not distribute
- ► Income would be taxed in Netherlands
- ► Result: CFC Charge in Netherlands
- ► AND Income would be taxed in Ireland
- ► Result: CFC Charge in Ireland

Unless: Exception Applies (e.g. substantial economic activity test is applied to non-EEA)



Controlled Foreign Company (CFC) Rule

Transactional Approach

- Non-distributed income from transactions
- Not “genuine” arrangements
- Essential purpose of obtaining a tax advantage

- Not own assets / undertaken risks
- Controlled by a company
- Significant people functions
  - Relevant to assets / risks
  - Instrumental in generating the CFC’s income

Controlled Foreign Company (CFC) Rule

Optional Exclusions (Transactional Approach)

Accounting profits ≤ €750K <u>and</u> non-trading income ≤ €75K

Accounting profits ≤ 10% operating costs. Operating costs exclude:

- **costs of goods sold outside CFC's country of residence**
- **payments to 25%+ associates**

Controlled Foreign Company (CFC) Rule

Parent / Head-Office country tax rules

- Proportional allocation of profits / gains
- No deduction for CFC losses (carried forward)
- Credit for taxes paid by CFC
- Deduction against subsequently distributed income
- Deduction against sales proceeds on disposal of CFC

General Anti-Abuse Rule (GAAR)

Ignore Arrangement

Main Purpose: Tax Advantage

Defeats Object / Purpose of Law

Not Genuine

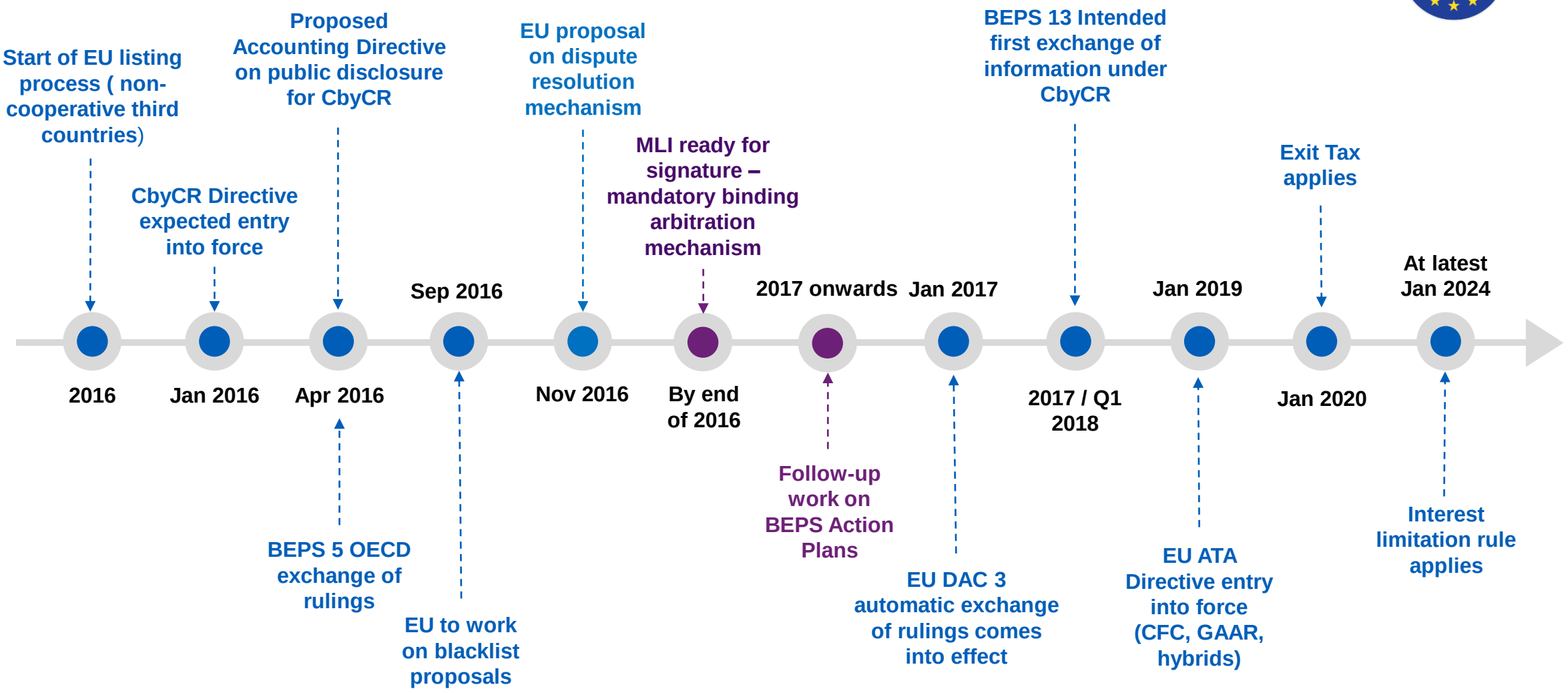
Business Impact

	Interest Limitation	Hybrids	Exit taxation	GAAR	CFC
Leasing industry	●	○	●	●	○
	• Ireland has a wide range of targeted anti-abuse measures • Increase effective tax rate • Asset finance sectors will be impacted • Could reduce scope of interest deductions in Irish leasing companies • Could limit the use of common EU funding structures • Financial undertakings e.g. banks and insurance companies excluded BUT treatment of unregulated entities within a regulated group is less clear • Use of orphans or securitisation vehicles	• Ireland has legislation addressing hybrid instruments • No branch exemption in Ireland - reduces scope for foreign branch mismatches • Limited impact for now: only covers intra EU hybrid structures - not that common in leasing sector • Proposals for non-EU transactions expected in October 2016. Treatment of entities "checked open" for US purposes will be important • Important that there is consistency in measures between OECD and EU	• Ireland's current exit tax regime does not apply to companies *ultimately* 90% controlled by EU or tax treaty resident persons. • Limited impact (if any) on Irish leasing sector as exit taxation regime not regularly used.	• Potentially limited impact given rule already closely aligned to Irish GAAR. • Likely to be reluctance to introduce ATA Directive GAAR in Member States where local GAAR already in use and considered to meet minimum standard in Directive	• Applies to each EU parent - shareholdings may need to be changed. Impact on tax grouping • CFC low tax test based on parent country income measure – differences in timing and availability of deductions could trigger low tax result • Potential to reduce attraction of establishing a holding company in Ireland

More to come?

EU	Other proposed measures including cross-border transparency on beneficial ownership, improving oversight of tax advisors and protection of whistle blowers.
OECD	Execution of Multilateral Instrument expected during 2017 to give effect to a number of the OECD BEPS recommendations. Discussion drafts issued on allocation of profits to PEs and other transfer pricing related matters.
EU	EU coordination on development of a “black-list” of non-EU jurisdictions in an effort to tackle perceived non-cooperative tax jurisdictions.
EU	Implementation of Directive on Administrative Cooperation (DAC3) – Automatic exchange of tax rulings to commence from 1 January 2017
EU	Introduction and implementation of Directive on Administrative Cooperation (DAC4) – Country-by-Country Reporting (closely aligned with OECD Action 13 Country-by-Country Reports)
EU	Introduction of Directive on Administrative Cooperation (DAC5) – providing tax authorities with access to national money-laundering information including beneficial ownership information for companies and trusts.
UK	Ongoing implementation of UK Diverted Profits Tax (DPT), expansion of scope of withholding tax and meaning of royalties, domestic anti-conduit treaty provisions, enactment of anti-hybrid mismatch measures, limitation on interest measures and proposals around publication of tax strategy for large businesses.

Timeline: What to expect?



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International Tax Developments - Leasing

International Tax Developments in the Leasing Industry

- **Argentina**
  - Lessors required to provide “Anexo 2228” confirming that lessor does not have PE in Argentina.

- **Australia**
  - Abolition of New South Wales mortgage duty and South Australia stamp duty.
  - Changes to GST Act – to come into effect on 1 October 2016.
  - Australian MAAL– applies to ‘significant global entities’.
  - Changes to Australian thin cap rules.

- **Brazil**
  - Updated ‘blacklist’ which now includes Ireland.
  - ‘Rental agreement’ exemption from withholding tax no longer available on lease payments to Irish lessors - 25% Brazilian withholding tax applies.
  - On 3 October 2016, Brazilian tax authorities issued ruling providing for a carve out from the operation of withholding tax on lease rental payments made to Irish lessors in respect of aircraft and engines until 31 December 2022.

International Tax Developments in the Leasing Industry

- **Korea**
  - Increased focus on beneficial ownership in applying treaty benefits.

- **Russia**
  - Changes to beneficial ownership rules – strict approach taken by Russian tax authorities.

- **Ukraine**
  - Ukrainian government considering implementing BEPS-style initiatives Ukraine from 1 January 2017.
  - Increased focus on beneficial ownership.
  - Initiatives include two additional tests for deciding on whether tax treaty relief should be applies – in particular, a “business purpose test” and a “substance test”.
  - Create issues in sub-leasing to Ukrainian carriers.

International Tax Developments in the Leasing Industry

- **UK**
  - Introduction of anti-hybrid mismatch rules.
  - Potential impact for UK leasing intermediary structures where there is ultimate “hybrid” financing in the group.

- **US Model Treaty**
  - New US Model Treaty has been released.
  - Several new provisions to deal with treaty abuse.
  - Ireland / US treaty being renegotiated.

Apple case

- **EU Commission decision on State aid**
  - EU Commission issue decision that Ireland provided State aid to Apple.
  - Ireland instructed by EU Commission to recover up to €13bn (plus interest and penalties).
  - EU Commission explicitly stated that “this decision does not call into question Ireland’s general tax system or its corporate tax rate”.
  - No other companies are subject to this decision – particular to the facts of the case.
  - Ireland’s position – full amount of tax was paid in this case and no State aid was provided.
  - Decision will be appealed by both Apple and Irish government.

Irish Tax Treaties

- **New treaties agreed**
  - Botswana (in effect 1 January 2017); Ethiopia (in effect January 2017); Pakistan (subject to ratification); Thailand; Ukraine; Zambia.

- **New protocols to existing treaties**
  - Belgium (subject to ratification); Germany; Luxembourg

- **Treaties being negotiated**
  - Azerbaijan; Ghana; Kazakhstan; Netherlands; Oman; Turkmenistan

- **Protocols being negotiated**
  - Mexico; South Africa

Thank you

Brian Brennan
Partner, Financial Services Tax
KPMG Ireland
Tel: +353 1 410 2145
Mob: + 353 87 744 2145
Email: brian.brennan@kpmg.ie

kpmg.ie