<u>Commentary on Typical Provisions of Irish Tax Treaties</u>

The following is a general commentary on the various articles found in typical Irish double tax treaties that follow the OECD model tax treaty.

It must be borne in mind however that particular Irish tax treaties may depart in some respect from the OECD model language and therefore the text of the actual article in the treaty should always be consulted. This is particularly the case with older Irish treaties. For the same reason, the article numbering used below may not always accord with the numbering in particular treaties.

PERSONS COVERED (ARTICLE 1)

This article provides that the terms of the treaty will apply to persons who are residents of either State or both. This is a central concept in all double taxation treaties. Benefits are only extended by one State to “residents” of the other State. Where persons are resident of both States, Article 4 (Resident) provides tie-breaker rules to determine a single State of residence for the purposes of the treaty.

TAXES COVERED (ARTICLE 2)

This article sets out the taxes to which the treaty will apply. In the case of Ireland these are income tax, corporation tax and capital gains tax. The similar direct taxes imposed by the other State are also covered. Inheritance and gift taxes are not covered by the treaties (but there are separate agreements covering these taxes in place with the UK and US). Also, indirect taxes (VAT or sales taxes) are not included.

The article provides that the treaty will apply to any identical or substantially similar taxes that may be subsequently imposed by either State.

GENERAL DEFINITIONS (ARTICLE 3)

This article defines a number of basic terms used in the treaty, generally following the standard definitions in the OECD model.

In relation to undefined terms, the article provides that the domestic law definition of the country applying the treaty should apply, unless the context in which the term is used in the treaty indicates otherwise. Both States must always interpret the treaty in good faith.

RESIDENT (ARTICLE 4)

This Article sets out the rules for determining whether a person is a resident of Ireland or a resident of the other State for the purposes of the treaty. Only residents of the Contracting States can claim the benefits of the treaty. A resident of a Contracting State is a person who is subject to comprehensive taxation in that State.

The article contains tie-breaker provisions to resolve cases where an individual would be regarded as a resident of both Contracting States. A series of tests apply to determine the State of which the taxpayer is resident. An individual cannot be dual resident for the purposes of the treaty.

The treaty will also normally contain a tie-breaker test for corporate entities. Where the entity is a resident of both States it will normally be deemed to be a resident of the State in which it is effectively managed. Some of Ireland's treaties simply leave the matter to be decided by the competent authorities under the mutual agreement procedure (see article 25).

PERMANENT ESTABLISHMENT (ARTICLE 5)

This article defines the term "permanent establishment". The concept of a permanent establishment is important for several other articles but is of primary importance for the purposes of Article 7 (Business Profits). Only when an enterprise of one of the Contracting States carries on business through a permanent establishment in the other State is its presence regarded as sufficiently substantial to allow that State to tax the business profits attributable to the permanent establishment.

A "permanent establishment" is defined as a fixed place of business through which the business of an enterprise is wholly or partly carried on.

The article contains an illustrative list of fixed places of business that will constitute a permanent establishment if they fit the general definition.

Construction sites are normally deemed to constitute a permanent establishment if they last for a period of more than twelve months. Many Irish treaties have shorter periods. Some Irish treaties also have provisions that deem a permanent establishment to exist if services are rendered in the other State for a sufficient period of time (eg, six months).

The article contains a list of exclusions - activities that will not constitute a permanent establishment even if there is a fixed place of business. The fundamental feature of these activities is that they are all of a preparatory or auxiliary nature.

The article also specifies the circumstances under which a dependent agent will constitute a permanent establishment even though the requirement of a fixed place of business is not satisfied. The agent must have and habitually exercise an authority to conclude business contracts on behalf of the enterprise.

However, if the agent is independent, such as a general commission agent acting in the ordinary course of its business, then the agent will not result in an enterprise being deemed to have a permanent establishment.

A controlled subsidiary or controlling parent does not of itself constitute a permanent establishment of its associated company unless the activities of the subsidiary or parent fall within the other provisions of the article.

INCOME FROM IMMOVABLE PROPERTY (ARTICLE 6)

The article provides that income from immovable property, including income from agriculture or forestry, may be taxed in the State in which the property is situated. However, the other Contracting State may also tax such income, subject to granting relief from double taxation under the relief of double taxation article.

The term "immovable property" is defined by reference to the domestic law of the Contracting State in which the property is situated.

The article also provides that the State of situs may tax income from immovable property of a resident of the other State even in the absence of a permanent establishment in the case of a business (i.e. the State of situs may tax notwithstanding the requirements of Article 7 (Business Profits) that, in order to be taxable, income must be attributable to a permanent establishment).

BUSINESS PROFITS (ARTICLE 7)

Under this Article, each Contracting State agrees not to tax the business profits of an enterprise of the other State unless the enterprise has a permanent establishment in that other State. If there is a permanent establishment, the other State may tax only the profits attributable to the permanent establishment. The article sets out the rules by which the profits of a permanent establishment are to be attributed.

The profits to be attributed to the permanent establishment are those that it would have been expected to make if it were a distinct and separate enterprise. This is what is known as the arms-length rule.

The article permits the profits of a permanent establishment to be determined on the basis of an apportionment of the total profits of the enterprise, provided such a determination is customary in the Contracting State concerned and the result is in accordance with the principles of the article. Profits of branches of foreign insurance companies are sometimes calculated on an apportioned basis.

No profit is to be attributed to a permanent establishment by reason of the mere purchase of goods by the permanent establishment. This provision is not concerned with an establishment existing solely for purchasing. Such an establishment would not be a permanent establishment under the principles of Article 5. It is concerned with a permanent establishment which carries on other business but also performs a purchasing function for its head office. In such a case, no profits are attributable to the purchasing function.

Where an enterprise has a permanent establishment in a Contracting State that receives any type of income dealt with in other articles, eg, interest, then the taxation of that income is determined by the rules of that other article.

SHIPPING AND AIR TRANSPORT (ARTICLE 8)

This article provides rules governing the taxation of profits from the operation of ships or aircraft in international traffic. The term “international traffic” is defined in Article 3 (General Definitions).

The article provides that the profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that Contracting State.

In several treaties the exempted profits are extended to include income from the rental of ships or aircraft in international traffic used in international traffic. In some cases this is limited to incidental leasing activities.

The article also applies to profits arising from participation in a pool or joint business.

ASSOCIATED ENTERPRISES (ARTICLE 9)

This article is concerned with transfer pricing.

It provides that the profits made by an enterprise from dealings with an associated enterprise in the other Contracting State may be increased to the level they would have been if the enterprises had been independent and dealing at arms-length. This is known as the “arm’s length” principle.

It also provides for the adjustment of profits of the associated enterprise in the other State as a consequence of an adjustment in the first State.

DIVIDENDS (ARTICLE 10)

This article is concerned with the taxation of dividends paid by a distributing company resident in one Contracting State to a shareholder resident in the other State.

It provides that the dividends may be taxed in the country of which the company paying the dividends is a resident at the specified rates, which are normally lower than the domestic law rates that would otherwise apply. The article normally provides for a lower rate of tax (often 5% of the gross dividend) where the owner of the dividends is a company that holds a minimum percentage of the shares (often 25%). The normal portfolio rate is often 15% of the gross dividend.

The term "dividends" is defined in the article. It normally covers income from shares or other rights, other than debt-claims, and includes income treated as income from shares under the laws of the source country.

The entitlement to the reduced withholding tax rates does not apply where the owner of the shares carries on business through a permanent establishment in the other State and the shares are effectively connected with that permanent establishment. The dividend income may instead be taxed at the normal business tax rate.

The article prevents the extra-territorial taxation of dividends. The paragraph precludes a Contracting State from taxing dividends which arise from profits sourced in that State but distributed by a non-resident company, except where such dividends are paid to a shareholder resident in that State or to a permanent establishment or fixed base situated in that State. It further precludes a Contracting State from imposing special taxes on non-resident companies in respect of undistributed profits.

INTEREST (ARTICLE 11)

This article provides rules for the taxation of interest arising in one Contracting State and paid to a resident of the other State.

The article normally provides that the interest may be taxed in the State in which it arises but if the beneficial owner of the interest is a resident of the other State the rate of tax is limited to a specified percentage of the gross interest payment. This will normally be lower than the tax rate that would otherwise apply. In several Irish treaties, the article provides for exemption from taxation in the source State, either for all interest payments or certain categories of interest (eg, paid to a bank).

There is a comprehensive definition of the term "interest" for the purposes of the article.

Where the beneficial owner of the interest carries on business through a permanent establishment in the other Contracting State, then the provisions of Article 7 (Business Profits) will apply and not the provisions of this article.

Interest is deemed to arise in the Contracting State when the payer of the interest is a resident there. However interest shall be deemed to arise in a Contracting State, even if the person paying the interest is not a resident, if the person has a permanent establishment in that State and the interest is borne by that permanent establishment.

The article deals with cases involving special relationships between the payer and beneficial owner of interest. In such cases the article will only apply to the extent that the interest does not exceed the amount that would have been paid between parties at arms-length.

ROYALTIES (ARTICLE 12)

This article provides rules for the taxation of royalties. It limits the taxation in the source State of royalties paid to a resident of the other State. While the OECD model treaty grants full exemption from taxation in the source State, many Irish treaties allow for reduced rates of taxation of gross royalty payments.

The term “royalties” is defined in the article and covers payments in respect of copyright of literary, artistic or scientific work as well as patents and trademarks. Some treaties also cover leasing payments – “payments for the use of, or the right to use, industrial, commercial or scientific equipment” – which would otherwise normally come under Article 7 (Business Profits).

The source State retains the right to tax royalties attributable to a permanent establishment of the beneficial owner in that State. In that case, the provisions of Article 7 (Business Profits) will apply and the source State may tax the income at the normal business tax rate.

Royalties are deemed to arise in the Contracting State that the payer is a resident of or, if paid in connection with a permanent establishment in the Contracting State, in the State where the permanent establishment is situated.

In cases involving special relationships between the payer and beneficial owner of a royalty, the provisions of the article will only apply to the extent that the royalty does not exceed the amount that would have been paid between parties at arm’s length.

CAPITAL GAINS (ARTICLE 13)

This article provides rules for source country and residence country taxation of capital gains.

The source country retains the right to tax gains from the alienation of immovable property situated in that State. The term "immovable property" is defined in Article 6 (Income from Immovable Property). Most Irish treaties include provisions that allow the source country to also tax gains from the disposal of shares that derive the greater part of their value from immovable property. This is an anti-abuse measure to prevent the interposition of a company by the owner of the property to facilitate the disposal of the property by means of a sale of the shares in the company.

Gains from the alienation of movable property pertaining to a permanent establishment (as referred to in Article 5) may be taxed in the State where the permanent establishment is situated.

The State of residence of the alienator of ships or aircraft operated in international traffic is given the exclusive right to tax any gains arising.

The State of residence of the alienator is granted the exclusive right to tax gains from property other than referred to in the preceding paragraphs of the Article. This would cover gains from the disposal of shares, other than shares deriving the greater part of their value from immovable property in the other State.

Most Irish treaties contain an exception in cases where a resident of a Contracting State was a resident of the other Contracting State any time during the three years preceding the disposal of property. In such cases, the former State of residence retains full taxing rights over gains from the disposal of property by such persons.

INDEPENDENT PERSONAL SERVICES (ARTICLE 14)

This article is no longer contained in the OECD model. The income is instead dealt with under Articles 5 (Permanent Establishment) and 7 (Business Profits). New definitions of "enterprise" and "business" have been added in Article 3 (Definitions) for this purpose.

However, many Irish treaties have this article, based on the OECD model that existed at the time they were negotiated.

The Article deals with income from professional services and mirrors the approach adopted in Article 5 and 7, namely, that the source State of such income may only tax it where it is attributable to a fixed base in that State.

The term “professional services” is defined as including income from the activities of various professions, such as lawyers, accountants, doctors, engineers, etc.

INCOME FROM EMPLOYMENT (ARTICLE 15)

This article provides for the taxation of income from employment (other than pensions).

It provides that remuneration in respect of an employment derived by an individual who is a resident of a Contracting State may be taxed only in that State unless the employment is exercised in the other Contracting State. In that event, the other State may tax the remuneration derived from the exercise of the employment in it.

However, the remuneration will be taxable only in the State of residence if the recipient is present in the other State for less than 183 days in any twelve month period and the remuneration is paid by an employer who is not resident in the other State (or is not borne by a permanent establishment or fixed base which the employer has in the other State).

There is an exception from this in the case of individuals employed as members of the regular crew of ships or aircraft operated in international traffic. Such employees may be taxed in the State of residence of the operator of the ships or aircraft.

DIRECTORS’ FEES (ARTICLE 16)

This article provides that a Contracting State may tax directors’ fees paid by companies that are residents of that State for services performed by residents of the other State in their capacity as members of the board of such companies. Accordingly, this Article overrides the general rules for the taxation of employment income in Article 15 (Income from Employment) in the case of directors’ fees.

ARTISTES AND SPORTSPERSONS (ARTICLE 17)

This article deals with the taxation of entertainers and sportspersons resident in one of the Contracting States and performing services in the other State.

It provides that income derived by a resident of one State from his or her personal activities as an entertainer or sportsperson exercised in the other State may be taxed in that other State. This overrides Article 15 (Income from Employment). Consequently, neither entertainers nor sportspersons can benefit from the 183-day exemption rule in Article 15.

The article also contains an anti-abuse provision. It is concerned with cases where income accrues to a third party in respect of the activities of the entertainers or sportspersons. It thus covers the situation where a company is formed, perhaps by the entertainer or sportsperson, to exploit the abilities of the entertainer or sportsperson with the company receiving the performance fees. Without the provisions of this paragraph, the company might claim exemption from tax because it earns business profits but has no permanent establishment in the host country. This paragraph ensures that protection cannot be claimed under Article 7 (Business Profits) where the entertainer or sportsperson has a right to participate in the profits of the person to which the income accrues.

PENSIONS and ANNUITIES (ARTICLE 18)

This article provides a general rule for the taxation of pensions and annuities.

It normally provides that a pension arising in a Contracting State and paid in consideration of past employment to a resident of the other Contracting State will be taxed only in that other State. In some treaties, the source country retains the right to tax pensions.

GOVERNMENT SERVICE (ARTICLE 19)

This article deals with the taxation of salaries, wages and other similar remuneration of government officials.

It provides that salaries paid by a Contracting State in respect of government service are taxable only in that State. However, they are taxable only in the other State where the services are performed in that State by a resident national of that State who did not become a resident solely for the purposes of rendering the services.

The article also covers government pensions. They are taxable only in the State of government paying the pension. However, where the individual is a resident and national of the other State, then that other State has the exclusive taxing right.

The paragraph also applies to employment income and pensions of individuals employed by a political subdivision or local authority of a Contracting State. Most Irish tax treaties require the services to be related to the discharge of core government functions.

The article does not apply to payments made in connection with any business carried on by or on behalf of one of the Contracting States or any of its political subdivisions or local authorities.

STUDENTS (ARTICLE 20)

This article provides for an exemption from tax in a Contracting State for payments received by a student, apprentice or business apprentice who is temporarily present in that State. To qualify, payments must be made for the student's maintenance, education or training and must come from sources outside that State.

PROFESSORS AND TEACHERS (ARTICLE 21)

Some Irish tax treaties contain a separate article dealing with the taxation of income of teachers and researchers who are temporarily working in a university, college or research institute in the other Contracting State. The article provides that the salary will be exempt in the other State for a period of two years. An individual may claim the exemption for one such two-year period only. The exemption does not apply if the research is undertaken primarily to benefit private persons.

OTHER INCOME (ARTICLE 22)

This article provides rules for the taxation of items of income not dealt with in other Articles of the treaty.

It contains a general rule that income of a resident of a Contracting State, which is not dealt with by any of the preceding articles, will be taxable only in that that State.

There is an exception to the general rule for income that is effectively connected with a permanent establishment in the other Contracting State; in such case, the provisions of Article 7 shall apply.

OFFSHORE ACTIVITIES

Several Irish tax treaties have a separate article dealing with income and gains from exploration and exploitation activities carried on in offshore waters. The article is intended to ensure that each state's taxation rights in respect of offshore activities are preserved in circumstances where they might otherwise be limited by other parts of the treaty. Special rules are required because of the short duration of some of these activities.

An enterprise of one Contracting State carrying on offshore exploration or exploitation activities in the other State is deemed to be carrying on business through a permanent establishment provided such activities are carried out for an aggregate of 30 days or more in any twelve months. Rules are also provided for determining when the 30-day threshold is exceeded where offshore activities are carried out by associated enterprises.

This overrides the provisions of Article 5 (Permanent Establishment) and Article 7 (Business Profits).

Remuneration derived by a resident of one Contracting State employed in offshore activities in the other State may be taxed in the other State. This overrides the provisions of Article 15 (Income from Employment).

ELIMINATION OF DOUBLE TAXATION (ARTICLE 23)

This article is relevant where both Contracting States retain taxing rights on items of income or gains. Double taxation is relieved in such cases by the State of residence of the taxpayer either exempting the income or gains from further taxation or granting credit for the tax paid in the other State.

Ireland adopts the credit method. In the case of dividends Ireland will, in addition to any taxation of the dividend payments made in accordance with Article 10, grant a credit for the tax paid by the company paying the dividends in respect of the profits out of which the dividends were paid (known as “underlying tax”).

The article also includes a sourcing rule, deeming income that is taxed in the other State in accordance with the treaty to be sourced there. This is necessary to allow the other State to grant exemption or credit under its domestic law.

Normally the article also allows a Contracting State, when calculating the amount of tax payable by a resident, to take account of income that resident may have which is exempt from tax by virtue of the treaty (known as “exemption with progression”).

Where the State of residence of an individual taxes only the amount of income or gains that are remitted to that State and not the full amount thereof, the other State is not obliged to grant treaty benefits in respect of so much of the income or gains that are not taxed. This takes account of the remittance basis of taxation that Irish resident but non-domiciled individuals may enjoy.

NON-DISCRIMINATION (ARTICLE 24)

This article provides that nationals of one Contracting State shall not be subject in the other State to any taxation requirement which is other or more burdensome than the taxation or connected requirements that apply to nationals of the other State in the same circumstances. Persons who are not resident in the same State are not in the same circumstances.

It also provides that one Contracting State may not tax a permanent establishment of an enterprise of the other less favourably than it taxes its own enterprises. This however does not entitle a resident of one Contracting State to claim personal tax allowances or reliefs in the other Contracting State.

Interest, royalties and other disbursements paid by a resident of one State to a resident of the other State must be allowed as a deduction against the tax of the first-mentioned resident under the same conditions as if they had been paid to a resident of the first-mentioned State.

The article also provides that an enterprise in one Contracting State which is owned or controlled by residents of the other State must not be subject in the first-mentioned State to any taxation or connected requirement which is different or more burdensome that the taxation or requirements that apply to similar enterprises of that first-mentioned State.

MUTUAL AGREEMENT PROCEDURE (ARTICLE 25)

This article provides for co-operation between the competent authorities of the two Contracting States to resolve disputes that may arise under the treaty and to resolve cases of double taxation not provided for in the treaty.

It provides that a resident of a Contracting State may appeal to the competent authority of that State if the person considers that tax is not being imposed in accordance with the treaty. It is not necessary to first exhaust remedies provided for under national law.

The article sets out the action that a competent authority must take if it considers a claim to be justified. It must first try to resolve the issue itself and, if it cannot, for example, if it considers that the other State should give relief, it must try to resolve the case by mutual agreement with the other competent authority. There is no requirement to reach agreement, merely to endeavour to do so.

The article also provides that the competent authorities of the two Contracting States shall endeavour to resolve any general difficulties or doubts regarding the interpretation or application of the treaty.

The competent authorities may communicate directly with each other i.e. they do not have to use diplomatic channels.

EXCHANGE OF INFORMATION (ARTICLE 26)

This article provides for the exchange of information that is relevant for the carrying out of the provisions of the treaty or of the domestic laws of the Contracting States concerning taxes covered by the treaty. All information so exchanged is to be treated as secret and disclosed only to persons concerned with the administration of the taxes to which the treaty applies.

There is no obligation to act or supply information other than in accordance with domestic law or normal administrative practice, or to supply information which would disclose trade secrets or would be contrary to public policy.

Under the new exchange of information article in the OECD model tax treaty, there are now explicit provisions that require a State to use its domestic information gathering measures to obtain information requested by the other State even if it does not need the information for its own purposes. This is designed to overcome any “domestic tax interest” requirement that would otherwise frustrate information exchange. The new article also requires States to exchange information held by banks and other financial institutions, thus overriding domestic bank secrecy provisions that might otherwise prevent exchange of information for tax purposes. While it is Ireland’s policy to include these new provisions in future treaties, they are not in any treaties concluded up until the end of 2006. However, Revenue powers allow it to meet these new standards and therefore information can be provided in accordance with these new terms under the exchange of information provisions of most pre-2007 treaties.

MEMBERS OF DIPLOMATIC MISSIONS AND CONSULAR POSTS (ARTICLE 27)

This article preserves the fiscal privileges accorded to diplomats and consular officers under general international law and other international agreements.

ENTRY INTO FORCE (ARTICLE 28)

This article provides that each Contracting State will notify the other of the completion of the procedures required by its law for the bringing into force of the treaty. The treaty will enter into force on the date of receipt of the later of these notifications and will normally have effect for tax periods in the following year.

TERMINATION (ARTICLE 29)

This article provides that either Contracting State may terminate the treaty by giving notice of termination through diplomatic channels. The treaty will then cease to have effect for following tax periods.