May 2021

Tax Treaty Policy

Response to the Public Consultation

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1. About the Irish Tax Institute

The Irish Tax Institute is the leading representative and educational body for Ireland's Chartered Tax Advisers (CTA) and is the country's only professional body exclusively dedicated to tax.

The Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice. We benchmark our education programme against the very best in the world. The continued development of our syllabus, delivery model and assessment methods ensure that our CTAs have the skills and knowledge they need to meet the ever-changing needs of their workplaces.

Our membership of over 5,000 is part of the international CTA network which has more than 30,000 members. It includes the Chartered Institute of Taxation UK, the Tax Institute of Australia, and the Taxation Institute of Hong Kong. The Institute is also a member of the CFE Tax Advisers Europe (CFE), the European umbrella body for tax professionals.

Our members provide tax services and business expertise to thousands of Irish owned and multinational businesses as well as to individuals in Ireland and internationally. Many also hold senior roles in professional service firms, global companies, Government, Revenue, state bodies and in the European Commission.

The Institute is, first and foremost, an educational body but since its foundation in 1967, it has played an active role in the development of tax administration and tax policy in Ireland. We are deeply committed to playing our part in building an efficient and innovative tax system that serves a successful economy and a fair society. We are also committed to the future of the tax profession, our members, and our role in serving the best interests of Ireland's taxpayers in a new international world order.

Irish Tax Institute - Leading through tax education

2. Summary

The Institute welcomes the opportunity to respond to the public consultation on Ireland's tax treaty policy.

Bilateral tax treaties are an essential part of the tax framework, particularly for small open economies, such as Ireland, which are export focused. Ireland's tax treaty network plays a vital role in supporting trade and investment between Ireland and treaty partner countries by eliminating double taxation and providing tax certainty for taxpayers. It helps Irish businesses to access foreign markets and encourages foreign inward trade and investment.

In a world that is continuing to contend with the impact of the COVID-19 pandemic, now more than ever businesses need certainty to make the necessary investment decisions required to support the economic recovery. We believe an internationally agreed tax framework is an essential tool in achieving the certainty needed to facilitate cross-border trade and investment. However, the proposals under discussion at the OECD/G20 to reform the global corporate tax framework are predicted to substantially reduce Ireland's annual corporation tax revenues in the coming years. Therefore, Ireland needs to ensure that it remains an attractive location for foreign direct investment, while also supporting Irish businesses to develop new markets following Brexit.

It is critical that Ireland continues to develop an extensive tax treaty network which removes barriers for Irish businesses competing in foreign markets and encourages further inward trade and investment from treaty partner jurisdictions. As the entire economy can benefit from an extensive network of tax treaties, the Institute supports the continuation of the existing policy to expand and maintain Ireland's tax treaty network.

As a general principle when negotiating treaties, Ireland should seek to align its treaties as closely as possible with the OECD Model Tax Convention and seek to ensure consistency in the classification of payments for withholding tax purposes across our treaty network. Where an existing treaty partner has agreed more favourable terms with another country, Ireland should seek to renegotiate its treaty with that treaty partner.

We believe that Ireland's tax treaty policy should reinforce the positions taken when Ireland adopted the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS ("the MLI"). The Institute supports Ireland's continued reservation of its position on Article 12 of the MLI regarding permanent establishments as we believe it significantly extends the circumstances in which a taxable presence in a country may be deemed to exist at a time when there is considerable debate over how and where multinational enterprises should be taxed.

In respect of dual-resident entities, it is critical that certainty regarding residence can be provided on a timely basis and in our view, where this is not possible, it would be desirable for taxpayers to have the option to request binding arbitration.

Access to the benefits of our treaty network is an important consideration for certain sectors for example, in the case of funds and asset management. Where it is the policy intention that an entity is subject to Irish tax rules, consideration should be given to domestic legislative changes to facilitate access to a tax treaty where this may otherwise not be possible. Indeed, if agreement is reached on the ‘subject to tax’ proposals outlined in the OECD Blueprint on Pillar Two,[1] it would be essential that certainty is provided on when an entity is considered to be subject to tax in Ireland.

In our view, Ireland should be open to negotiate bilateral tax treaties with developing countries to help support such countries in their endeavours to attract inward investment. Given that a tax treaty not only helps to strengthen economic ties by avoiding double taxation, but also helps prevent tax avoidance and tax evasion, Ireland should seek to extend its treaty network with developing countries.

In doing so, Irish policymakers should follow the OECD Model Tax Convention as far as possible when negotiating with developing countries to ensure consistency with Ireland’s overall tax treaty network, whilst considering the inclusion of some provisions from the United Nations Model Double Taxation Convention (“UN Model Treaty”), where appropriate, to help support trade and investment with such developing jurisdictions.

We have summarised in section 3 of this submission, the Institute’s recommendations for Ireland’s tax treaty policy based on the feedback we have received from our members over the last four weeks. We have outlined in further detail our responses to the consultation questions in section 4. It has not been possible to carry out an in-depth analysis of the provisions of each of Ireland’s existing tax treaties within the short timeframe provided for this consultation.

The Institute would be happy to engage further in this consultation through stakeholder meetings or direct discussions. Please contact Anne Gunnell at agunnell@taxinstitute.ie or (01) 6631750 if you require any further information.

[1] OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting, OECD Publishing, Paris

3. Institute Recommendations

Economic Considerations

1. It is essential that the existing policy of expanding and maintaining Ireland's tax treaty network should continue to ensure Irish businesses can easily access new markets without suffering double taxation and to encourage inward trade and investment from treaty partner jurisdictions.

2. When negotiating tax treaties, Ireland should continue to align its treaties as closely as possible with the OECD Model Tax Convention and seek to ensure consistency in the classification of payments for withholding tax purposes across Ireland's tax treaty network.

3. Consideration should be given to including a most favoured nation clause in double tax treaties. Where an existing treaty partner has agreed more favourable terms with another country, Ireland should seek to renegotiate its bilateral tax treaty with that country. Consequently, our members have identified Ireland's tax treaties with Australia, Japan and Malaysia as requiring renegotiation.

4. Ireland's tax treaty policy should reinforce the positions taken by Ireland when it adopted the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS ("the MLI").

5. The Institute supports Ireland's continued reservation of its position on Article 12 of the MLI as we believe it significantly extends the circumstances in which a taxable presence in a country may be deemed to exist at a time when there is considerable debate over how and where multinational enterprises should be taxed at the OECD/G20.

6. Given the Pillar One[2] proposal under consideration by the OECD/G20 Inclusive Framework on BEPS to reform the global corporate tax framework is likely to significantly alter the circumstances when a taxable presence would be deemed to exist in a market jurisdiction, it may be appropriate to revisit Ireland's tax treaty policy regarding permanent establishments when the technical details of any solution agreed at OECD/G20 level are finalised.

7. Where the tie-breaker rule in Article 4 of the MLI applies to dual-resident entities, it is critical that certainty on the residence position can be provided by the respective competent authorities on a timely basis. In our view, where this is not possible, it would be desirable for taxpayers to have the option to request binding arbitration.

8. Where it is the policy intention that an entity is considered subject to Irish tax rules, even though it is not liable to tax, like in the case of investment funds, we believe it

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[2] OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting, OECD Publishing, Paris.

would be appropriate for policymakers to renegotiate certain older treaties to ensure these entities are covered by the relevant treaty provisions. Indeed, if agreement is reached on the 'subject to tax' proposals outlined in the OECD Blueprint on Pillar Two, it would be essential that certainty is provided on when an entity would be considered to be subject to tax in Ireland.

9. Based on feedback from members and subject to political and diplomatic considerations, new bilateral tax treaties with Argentina, Brazil, Indonesia, Philippines, and Taiwan would be welcomed, given the large trade flows between Ireland and those countries. New tax treaties with Bangladesh, Bolivia, Colombia, Mongolia, Nigeria and Sri Lanka have also been identified by members advising companies in the leasing sector to enhance the scope and breath of Ireland's tax treaty network in the coming years.

Policy on Developing Countries

10. In our view, Ireland should continue to negotiate double tax treaties with developing countries to promote trade and support their endeavours to attract inward investment. In doing so, Irish policymakers should follow the OECD Model Tax Convention to ensure consistency across Ireland's tax treaty network, whilst including provisions from the UN Model Treaty as may be appropriate.

11. In line with the OECD recommendation in its 1998 report on tax sparing, consideration could be given to including tax sparing credits in double tax treaties with developing countries for a time-limited period but only with respect to specific measures to attract foreign direct investment in such a country whose economic level is considerably below that of Ireland.

12. In our view, should a bilateral tax treaty between Ireland and a developing country grant the source state a right to tax fees for technical services, it would be crucial that the scope of income which would be considered to be covered by such a clause is clearly defined.

4. Response to Consultation Questions

4.1 Economic Considerations

In a world that continues to contend with the fallout of the COVID-19 pandemic, businesses need to be provided with certainty to allow them to make the necessary investment decisions required to assist with the economic recovery. Tax certainty is recognised as a key factor that influences investment and other commercial decisions and therefore has a significant impact on economic growth.[3]

We believe establishing legal and tax certainty in the international tax framework will be of utmost importance in facilitating cross-border trade and investment. However, with the current proposals for international corporate tax reform predicted to result in annual corporation tax revenues in Ireland possibly decreasing by up to €2 billion by the mid-part of this decade[4], Irish policymakers must ensure that Ireland remains an attractive location for foreign direct investment, while also supporting Irish businesses to develop new markets following Brexit.

Tax treaties prevent the double taxation of businesses operating across borders and are an essential part of the tax framework providing certainty for taxpayers, particularly for countries, such as Ireland, which has a small domestic market and is highly export focused. It is critical that Ireland continues to develop an extensive tax treaty network which removes barriers for Irish businesses competing in foreign markets and encourages further inward trade and investment from treaty partner jurisdictions.

The increasing digitalisation of the economy has undoubtedly created challenges for the existing international corporate tax framework. The Institute supports the ongoing work at the G20 and OECD level to reach a stable global consensus-based solution. The proposals outlined in the OECD Blueprints on Pillar One[5] and Pillar Two[6] will impact on how and where companies are taxed. It is possible that implementation of any globally agreed solution could involve the adoption of a multilateral instrument which would further modify Ireland's existing tax treaties.

As Ireland has indicated its preference for a global multilateral solution to address the tax challenges of the digital economy, we believe that adopting provisions of Article 12B of the UN Model Treaty in relation to income arising from automated digital services would be a considerable departure from the Irish policy position thus far.

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[3] IMF/OECD (2019), 2019 Progress Report on Tax Certainty, Paris. www.oecd.org/tax/tax-policy/g20-report-on-tax-certainty.htm

[4] Department of Finance, Draft Stability Programme Update 2021 Incorporating the Department of Finance's Spring Forecasts, April 2021

[5] OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting, OECD Publishing, Paris.

[6] OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting, OECD Publishing, Paris.

In our view, it would be appropriate to revisit Ireland's tax treaty policy when the technical details of any solution agreed at the OECD/G20 are finalised and there is clarity regarding the outcome of relevant EU initiatives seeking to address the issue of fair taxation related to the digitalisation of the economy.

As the entire economy can benefit from an extensive network of tax treaties, the existing policy of expanding and maintaining Ireland's tax treaty network should continue. Ireland's existing tax treaty network currently stands at 74, with 73 in effect. Despite a broad coverage of Ireland's existing treaty network, there are also some significant gaps across Latin America, southern Asia and Africa.

Based on feedback we have received from members and subject to political and diplomatic considerations, new bilateral tax treaties with Argentina, Brazil, Indonesia, Philippines, and Taiwan would be welcomed, given the large trade flows between Ireland and those countries. Some sectors, such as leasing and asset management, rely significantly on treaty provisions to operate effectively cross-border. New tax treaties with Bangladesh, Bolivia, Colombia, Mongolia, Nigeria and Sri Lanka have also been identified by members advising companies in the leasing sector to enhance the scope and breath of Ireland's tax treaty network in the coming years.

Negotiating a bilateral tax treaty requires commitment and cooperation from both countries, nonetheless, all efforts possible should be applied to addressing these gaps. In fact, the outcome of the negotiations on international tax reform at the OECD may provide countries, including Ireland, with a renewed momentum and mandate to negotiate.

Specific Provisions in Double Tax Treaties

As a general principle when seeking to negotiate tax treaties, Ireland should align its treaties, in our view, as closely as possible to the OECD Model Tax Convention and seek to ensure consistency in the classification of payments for withholding tax purposes across our tax treaty network.

Ireland should seek to negotiate a zero withholding tax rate on dividends between associated entities as far as possible. This would encourage free movement of capital and would be consistent with the introduction of a participation exemption for foreign dividends should Ireland adopt such an exemption following the public consultation on moving to a territorial regime due to be launched this year.[7]

Consideration could be given to allowing for binding arbitration as an option for taxpayers and non-discrimination and most favoured nation clauses should be included in treaties where possible.

Where an existing treaty partner has agreed more favourable terms with another country, Ireland should seek to renegotiate its bilateral tax treaty with that treaty partner. Consequently, our members have identified the tax treaties with Australia,

[7] Ireland's Corporation Tax Roadmap January 2021 Update, page 10.

Japan and Malaysia as requiring renegotiation. For example, the rate of withholding tax on royalties in the Ireland/ Japan and the Ireland/ Malaysia tax treaties does not compare favourably with tax treaties that those countries have concluded with other jurisdictions. Similarly, the circumstances in which an enterprise shall be deemed to have a Permanent Establishment is wider under the terms of the Ireland/ Australia tax treaty compared to what is provided for in Australia's tax treaties with other jurisdictions, such as the UK and the US.

Regarding the Ireland/ US tax treaty, the US Model Treaty would likely form the primary basis for negotiation of any new treaty. The challenges that the US Model Treaty would present from an Irish perspective that were outlined in the Institute's response[8] to the 2016 public consultation on the matter remain, in particular, the widespread impact that a Limitation on Benefits article ("LOB"), would have for all company types.

Where there is a policy objective to increase investment in a particular area, for example, in renewable technologies, consideration could be given to agreeing to a reduced withholding tax for companies operating in the relevant sector.

The MLI, which Ireland signed in 2017, modifies the application of Ireland's tax treaties where both Ireland and the relevant treaty partner have fully ratified the convention in their domestic law and lodged their ratification instruments with the OECD. Minimum standards to counter treaty abuse and to improve dispute resolution mechanisms are set out in the MLI. We believe that Ireland's tax treaty policy should reinforce the positions[9] taken by Ireland when it adopted the MLI.

Permanent Establishments

Article 12 of the MLI puts forward a new test for when an agent can constitute a Permanent Establishment (PE) in a country and consequently, create a taxable presence in that jurisdiction. Like many of Ireland's treaty partners, Ireland reserved its position on Article 12 because work is still underway at the OECD/G20 level to determine what profits, if any, would be attributable to a PE created under this new test and the continuing significant uncertainty as to how the test would be applied in practice.[10]

The Institute supports Ireland's continued reservation of its position on Article 12 of the MLI, as we believe it significantly extends the circumstances in which a taxable presence in a country may be deemed to exist at a time when there is considerable debate over how and where multinational enterprises should be taxed. The Pillar One[11] proposal under consideration at the OECD/G20 Inclusive Framework on BEPS

[8] https://taxinstitute.ie/wp-content/uploads/2018/02/ITI-Draft-US-Treaty-Final-Submission-.pdf
[9] https://www.oecd.org/tax/treaties/beps-mli-position-ireland-instrument-deposit.pdf
[10] Technical Briefing Note, Ireland's approach to the OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS, Department of Finance
[11] OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting, OECD Publishing, Paris.

as part of the ongoing international discussions to reform the global corporate tax framework would significantly change the circumstances when a taxable presence would be deemed to exist in a market jurisdiction. In light of this, it may be appropriate to revisit Ireland's tax treaty policy on the PE article when the technical details of any solution agreed at OECD/G20 level are finalised.

In the meantime, feedback from our members would suggest that additional clarity on the circumstances in which servers and data centres may be considered to constitute a PE under existing provisions would be welcomed.

Dual-Resident Entities

Ireland adopted Article 4 when it deposited its instrument of ratification of the MLI at the OECD, resulting in the tie-breaker rule for dual resident entities applying to Irish tax treaties where the corresponding treaty partner has ratified the MLI and has also opted for the same rule. Article 4 contains a tie-breaker rule for determining the tax residence of companies which are deemed to be a resident of more than one jurisdiction under domestic provisions. In such a scenario, Article 4 provides that the competent authorities of the relevant jurisdictions shall endeavour to determine a sole jurisdiction of residence by mutual agreement having regard to that company's place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors.

Under the Article 4 tie-breaker rule, a dual-resident company will lose its automatic single jurisdiction of residence status for treaty purposes that is based on place of effective management only. Instead, the competent authorities will endeavour to resolve the residence status by mutual agreement having regard to the relevant factors. If agreement cannot be reached on the residence status for treaty purposes, the company will only be entitled to treaty benefits to the extent that the competent authorities agree.

We have received feedback from members that the competent authority agreement process can be administratively burdensome for taxpayers and creates uncertainty. We understand that commercial decisions can be delayed or indeed postponed, in the transitional period pending agreement on the residence position of a company. It is critical that certainty regarding residence can be provided on a timely basis and in our view, where this is not possible, it would be desirable for taxpayers to have the option to request binding arbitration.

It is worth noting that HMRC in the UK updated its guidance regarding dual-resident companies to outline its approach in cases where an existing tax treaty is modified by the MLI.[12]

[12] INTM120070, under the section "DTAs with standard tie-breakers".

In the guidance, HMRC confirms that:

> *"Where an existing DTA is modified by the MLI and a company was subject to the tie-breaker of Article 4 and determined to be resident in only one of the countries before the modification came into effect, HMRC will generally not seek to revisit any previous determination of the treaty residence position so long as all the material facts remain the same. However, if the arrangements in relation to which the determination has been made are such that any treaty benefits under them would be denied under the conditions of the Principal Purpose Test (PPT) in paragraph 9 of Article 29 of the 2017 OECD Model Tax Convention then HMRC would review the prior determination. Where HMRC believes arrangements in relation to which the determination has been made are such that any treaty benefits under them would be denied under the conditions of the PPT, HMRC may seek a new determination from the date on which the modification came into effect.*
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> *In other cases, where the material facts change after the modification came into effect, HMRC would generally seek for any new determination (or the loss of treaty benefits pursuant to the absence of a mutual agreement) to apply only to income or gains arising after the new determination (or notice to the taxpayer of the absence of an agreement) but this will depend on the facts and circumstances."*

While the updated guidance notes that HMRC cannot apply the above approach unilaterally, which is subject to agreement between the competent authorities, it provides UK businesses with some certainty on how HMRC will approach such situations.

There is now some inconsistency across Ireland's tax treaty network following the adoption of Article 4 of the MLI regarding the test to be applied in determining the tax residence of companies because where Article 4 does not apply, the sole jurisdiction of residence continues to be determined in most cases using the place of effective management test.

Accessing Treaty Benefits

Article 3 of the MLI seeks to regulate the circumstances in which treaty benefits are granted if income or benefits are received by or through a hybrid entity. When considering the application of Article 3 of the MLI, it is key that taxpayers and their advisers understand Revenue's position regarding the classification of foreign entities.

We understand from recent discussions at the Tax Administration Liaison Committee (TALC) that principle-based guidance on foreign entity classification for tax purposes is currently being developed by Revenue and we would welcome the publication of such guidance. In our view, it would be important that this guidance also considers the classification of entities for the purposes of Ireland's tax treaties.

We believe that it may be appropriate to consider domestic legislative changes to facilitate access to a tax treaty in certain circumstances. With the introduction of EU Anti-Tax Avoidance Directive (ATAD 2)[13] reverse-hybrid rules from 1 January 2022, issues may arise for certain entities that are considered transparent for treaty purposes (for example, Common Contractual Funds and Investment Limited Partnerships).

In addition, the classification of an entity as opaque in circumstances where it is not liable to tax in Ireland, for example an ICAV, could result in that entity being prevented from accessing certain tax treaties. For example, Article 4 of the Japan/ Ireland tax treaty defines residence by reference to a person that is liable to tax in a Contracting State, which can create difficulties for fund vehicles, like an ICAV, to access the treaty because even though the fund is subject to tax in Ireland, it is not liable to tax under section 739C Taxes Consolidation Act 1997 (TCA 1997).

Where it is the policy intention that an entity is subject to Irish tax rules, it should be clear that they would have access to Ireland's tax treaty network. Indeed, if agreement is reached on the 'subject to tax' proposals outlined in the OECD Blueprint on Pillar Two,[14] it would be essential that certainty is provided on when an entity is considered to be subject to tax in Ireland.

When determining eligibility for certain tax reliefs and exemptions, Irish tax law requires consideration of whether a company is resident in a tax treaty country. For example, section 626B TCA 1997 provides for an exemption from tax on certain capital gains from the disposal of holdings in subsidiaries. One of the conditions of section 626B requires consideration of whether a company is "*by virtue of the law of a relevant territory, resident for the purposes of tax in the relevant territory*".

However, this condition can give rise to uncertainty as some countries, such as Hong Kong, do not have a domestic concept of tax residence. We would suggest that wording could be introduced into the TCA 1997 to clarify that a company that is resident in a territory for the purposes of a double tax treaty with Ireland shall be considered to be so resident "by virtue of the law of" that territory.

Capital Acquisitions Tax

Ireland has only two capital acquisitions tax (CAT) treaties in operation, one with the UK negotiated in 1977 and the other with the US, negotiated in 1950. The agreements in place recognise the historic links between the countries involved and Ireland's diaspora. However, with overseas investment by individuals becoming increasingly common, we believe it would be appropriate to consider concluding new double tax treaties in respect of CAT, particularly for countries within the EU.

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[13]Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries.

[14] OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting, OECD Publishing, Paris.

4.2 Policy on Developing Countries

The consultation paper notes that developing countries may seek to negotiate double tax agreements as a means of attracting foreign direct investment and asks when negotiating with developing countries whether more emphasis should be placed on the UN Model Treaty.

The UN Model Treaty, although broadly similar to the OECD Model Tax Convention, goes further in granting taxing rights to the state of source, particularly in relation to business profits and income from movable capital, such as dividends, interest and royalties. It is interesting to note the commentary contained in the Netherlands' 2020 Memorandum on Tax Treaty Policy regarding the OECD Model Tax Convention and the UN Model Treaty:

> *"The OECD Model Tax Convention is more effective than the UN Model Double Taxation Convention in preventing double taxation. This is because the UN Model Double Taxation Convention, in addition to regulating withholding taxes on dividend and interest payments, also provides for additional withholding taxes on certain gross money flows (such as royalties and fees paid for technical services) that do not always qualify for a full credit in the state of residence because the basis of taxation in the state of residence is the taxpayer's net income, i.e. after deduction of relevant expenses. This may have a detrimental effect on cross-border trade and investments."*

The 2015 IBFD Spillover Analysis[15] noted that most tax treaties concluded by Ireland contain provisions that are similar to those in tax treaties by other developed countries with the same developing countries, and they include several UN-type provisions considered favourable to developing countries.

In our view, Ireland should be open to negotiations on double tax treaties with developing countries to help support such countries in their endeavours to attract inward investment. Given that a tax treaty not only helps to strengthen economic ties by avoiding double taxation, but also helps prevent tax avoidance and tax evasion, Ireland should seek to extend its treaty network with developing countries.

In doing so, we believe that Ireland should be consistent in its approach to tax treaties and policymakers should follow the OECD Model Tax Convention when negotiating with developing countries, whilst including provisions from the UN Model Treaty as may be appropriate.

It must also be recognised that the proposals under discussion by the OECD/G20 Inclusive Framework on BEPS (which comprises 139 jurisdictions, including developing countries) to reform the international corporate tax framework are likely to

[15] IBFD Spillover Analysis, Possible Effects of the Irish Tax System on Developing Economies, July 2015, Department of Finance, page 6

have consequences for developing countries and therefore may impact treaty negotiations with such countries.

As many developing countries rely on withholding taxes to collect tax revenue, a tax treaty that significantly lowers withholding taxes that may be levied by the source state may lead to a substantial loss of tax revenue for a developing country. However, excessively high withholding taxes imposed on dividends, interest and royalties can be a barrier to foreign investments so urgently needed by developing countries[16].

In our view, in negotiating the appropriate level of withholding taxes which may be levied on dividend, interest and royalties, the specific circumstances of the developing country must be taken into account whilst recognising the extent of Ireland's current Exchequer deficit.

Tax Sparing Credits

The 2015 IBFD Spillover Analysis noted that almost all developing countries use tax incentives to attract foreign direct investment. Often these tax incentives take the form of tax holidays and a reduction of corporate taxes and withholding tax rates. However, as Ireland currently operates a worldwide tax system and does not have a participation exemption, the foreign tax credit available for offset as a consequence of such incentives is lower than the Irish equivalent rate, resulting in incremental tax levied on the foreign source income in Ireland. In these circumstances, the tax foregone by the developing country does not benefit the investor and can undermine the intended policy aim of offering the tax incentive.[17]

The inclusion of tax sparing credits in double tax treaties concluded with developing countries seek to address this issue. Where a developing country grants tax incentives to encourage foreign inward investment, the country where the recipient of the income is resident may give a credit against its own tax revenues on income received from the developing country for the tax which would have been paid in the developing country, if the tax had not been "spared" under the provisions of the tax incentives.

We note that the *Commentary to the United Nations Model Double Taxation Convention between Developed and Developing Countries: 2017 Update* states that tax sparing provisions are still features of tax treaties between developed and developing countries although there is a tendency for them to be more time-limited than previously.[18] It observes that sometimes there is a break or sunset clause providing for the provision to be terminated after, say, five years, unless the treaty partners agree to an extension.

[16] The Netherlands 2020 Memorandum on Tax Treaty Policy at paragraph 5.2.3
[17] IBFD Spillover Analysis, Possible Effects of the Irish Tax System on Developing Economies, July 2015, Department of Finance, page 56
[18] United Nations Model Double Taxation Convention between Developed and Developing Countries: 2017 Update, Commentary on Article 23, Methods for Elimination of Double Taxation, paragraph 12

The OECD report, *Tax Sparing, A Reconsideration,*[19] recommended OECD member countries to limit the inclusion of tax sparing credits in tax treaties because the provisions had been subject to abuse by taxpayers in some cases. However, the report also acknowledged that tax sparing credits were an important element for many developing countries to attract foreign direct investment. For this reason, the OECD recommended that tax sparing credits should only be considered in tax treaties with countries the economic level of which is considerably below that of the OECD member country and with respect to specifically mentioned measures to attract foreign direct investment.

If these conditions are met, the report notes that tax sparing credits could be effective for a limited period of time. With a view to supporting developing countries to attract foreign investment, we believe that Irish policymakers could consider including tax sparing credits in double tax treaties in the limited circumstances set out in the OECD report.

Fees for Technical Services

Since 2017, the UN Model Treaty, unlike the OECD Model Tax Convention, includes a special clause granting the state of source the right to tax fees for technical services.[20] The issues surrounding the inclusion of such a clause in tax treaties with developing countries is considered in the Netherlands' 2020 Memorandum on Tax Treaty Policy[21] which outlines the limited circumstances where it is prepared to accept such a clause:

> *"The clause in the UN Model Double Taxation Convention does not restrict the state of source's taxing right in accordance with the place where the services in question were provided. This means that the state of source is still permitted to tax the fees paid for the services, even if there is only a tenuous link between the state of source and the services provided. Another problem with a state of source taxation of fees for technical services is that the tax base may not be large enough to permit an offset. This is because the state of source taxes the gross income, whereas the tax offset is based on the net income. As a result, any state of source tax that cannot be offset is likely to be passed on to the entity receiving the services, thus creating an obstacle to foreign investment. ….*
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> *Nonetheless, the Netherlands understands that, for developing countries with limited enforcement capacity, a state of source tax on fees for technical services may be a straightforward way of generating tax revenue. For this reason, the Netherlands is prepared to accept a state of source right to tax fees paid for technical services in negotiations with the poorest group of the most vulnerable developing countries. A key consideration for the Netherlands is that a state of source right to tax fees for technical services is permitted only if the services are*

[19] OECD (1998), *Tax Sparing: A Reconsideration*, OECD Publishing, Paris, https://doi.org/10.1787/9789264162433-en
[20] See article 12A of the UN Model Double Taxation Convention
[21] See paragraph 5.2.6

provided in the state of source, thus guaranteeing that there is a connection between the service and the state of source."

Given the range of issues arising with the provision of a right to tax gross income from technical services, it would be critical in our view that clarity is provided regarding the scope of the income which would be considered to be covered by such a clause should Ireland's tax treaties with developing countries grant the source state a right to tax fees for technical services.