Ireland's double tax treaties to be amended under unprecedented MLI

"*It's very innovative, it's new and it's unprecedented*" is how Pascal Saint-Amans, Director of the Centre for Tax Policy and Administration at the OECD, described the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the "**MLI**"). Ireland along with 67 other countries signed the MLI on 7 June 2017. As indicated by Pascal Saint-Amans, this is an important development in international tax. It is the first time a multilateral convention has been agreed to update a series of bilateral treaties.

The effect of the MLI will be to incorporate new provisions agreed under the base erosion and profit shifting ("**BEPS**") project into many of Ireland's double tax treaties ("**DTTs**"). The key changes to Ireland's DTTs that will be made under the MLI are:

- adoption of a principal purpose test ("**PPT**");
- adoption of a tie-breaker test based on mutual agreement to determine tax residence for dual resident entities; and
- adoption of a number of measures, including mandatory binding arbitration, to resolve DTT disputes more efficiently.

Although it is unclear at this stage when the changes will apply from, the very earliest date from which the changes are likely to apply is **1 January 2019**.

Perhaps of most interest, are Ireland's reservations to the MLI. Ireland will not:

- adopt the changes to the permanent establishment ("**PE**") definition designed to treat commissionaires as PEs;
- adopt the narrower specific activity exemptions within the PE definition.

What Irish DTTs will be affected by the MLI?

Ireland has agreed 73 DTTs (of which 72 are in effect). Ireland has confirmed that it will treat 71 of those DTTs as 'Covered Tax Agreements'. If the DTT partner also opts to treat the Irish DTT as a 'Covered Tax Agreement', that DTT will be amended by the MLI. If a DTT partner does not sign the MLI (the current US position) or does sign the MLI but does not opt to treat the Irish DTT as a 'Covered Tax Agreement' (the current Swiss position), no amendments will be made to that DTT under the MLI.

It has been bilaterally agreed not to include the Ireland / Netherlands DTT as a 'Covered Tax Agreement' as that DTT is currently being renegotiated.

A complete list of Ireland's DTTs is available here along with confirmation of which countries have indicated that they will treat the Irish DTT as a 'Covered Tax Agreement'.

What happens if Ireland adopts a change under the MLI and the DTT partner does not?

In that case, the DTT will not be updated. In order for a change to be effective, both countries must adopt the change under the MLI.

Will the dependent agent PE definition change?

One of the more controversial changes to the PE definition recommended under BEPS Action 7 was the change to the dependent agent PE definition. That change is designed to treat the appointment of a commissionaire as giving rise to a PE. Ireland will not adopt this change. The technical briefing note issued by the Department of Finance confirms that Ireland continues to reserve its position on this change *"due to the continuing uncertainty as to how the test will be applied in practice".*

Will the fixed place of business PE definition change?

In short, the existing fixed place of business safe harbours (e.g. for warehouses used for the storage of goods) will continue to apply regardless of whether the activities carried on at those places are preparatory or auxiliary in nature (unless the existing DTT currently provides otherwise).

The fixed place of business safe harbours in the PE definition will be further extended to expressly confirm that no PE will arise in a source country to the extent the activities carried on (regardless of whether they are specifically listed in the exclusions) are preparatory or auxiliary in nature.

Will any changes be made to the PE definition?

Yes. The anti-fragmentation rule will be adopted. In broad terms, that rule permits a source country to aggregate all of the activities of a taxpayer and its closely related enterprises in that country when determining whether or not the PE threshold is satisfied.

In a similar vein, a source country will be permitted to aggregate time spent on a building site, construction project or installation project by a taxpayer and its closely related enterprises in determining whether the PE threshold is met.

Has Ireland reserved on any other provisions?

Yes. Ireland will not adopt the savings clause. The savings clause included in the MLI is designed to preserve the right of each jurisdiction to tax its own residents, subject to certain exceptions. It is not a standard part of Irish DTT policy to seek inclusion of such clauses in Irish DTTs.

A number of provisions are designed for countries that adopt the exemption method of relief. Ireland operates a credit mechanism. Accordingly, the anti-abuse rule for PEs located in third countries and the changes to the methods for eliminating double taxation will not be adopted by Ireland.

What is the PPT?

The PPT is a general anti-avoidance clause that was agreed under Action 6 of the BEPS project. It can be invoked by a tax authority to deny benefits available under a DTT if obtaining the treaty benefit was "*one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit"*.

The PPT will increasingly become a feature of all DTTs. A small number of countries (including the US) are dissatisfied with the PPT. It is expected that those countries will adopt limitation on benefits ("**LOB**") provisions instead of the PPT. It is anticipated that countries that wish to include LOB provisions in their DTTs instead of the PPT will renegotiate those DTTs independently of the MLI.

What is the significance of the change to the tie-breaker provision?

Under most of Ireland's DTTs, if a company is regarded as resident in both countries under domestic laws, the relevant DTT will provide a mechanism to determine the place of residence. Under current DTTs, that country is typically determined by reference to the place of effective management ("**POEM**") of the company. A company's POEM is generally something that the taxpayer can identify without engaging with either tax authority.

Under the new tie-breaker provision included in the MLI, the country of residence of dual resident companies must be determined by mutual agreement between the tax authorities of both countries. For taxpayers that are currently relying on the POEM standard for the purposes of residence, this will cause an administrative headache and may create uncertainty in some cases.

By way of example, under Ireland's residence rules, a company incorporated in Ireland on or after 1 January 2015 will be treated as resident in Ireland unless it is treated as resident elsewhere under the terms of any Irish DTT. If that Irish company has its place of central management and control in the UK, it likely will also be regarded as tax resident in the UK under UK law. Under the terms of the existing Ireland / UK DTT, if the company is satisfied that its POEM is in the UK, it will be regarded as tax resident in the UK for the purposes of the DTT and accordingly as resident outside Ireland for the purposes of Irish law. Both Ireland and the UK have signed the MLI and both countries have opted to apply the new tie-breaker test. Accordingly, once the MLI becomes effective to update the Ireland / UK DTT, the company in this example would be required to initiate a mutual agreement procedure (a) to confirm its jurisdiction of residence for the purposes of the Ireland / UK DTT and (b) to confirm that it is not tax resident in Ireland under Irish law.

It is important to note that a number of Ireland's DTT partners (including Italy, Luxembourg and Malta) have reserved on this provision and under those DTTs the POEM standard will continue to apply. Where DTT partners have not reserved on this provision, it is hoped that the tax authorities will take a pragmatic approach to companies that have historically established place of residence under the POEM standard and will conclude those mutual agreement procedures quickly and efficiently. That said, any taxpayers currently relying on the POEM standard to establish residence under an Irish DTT that will be amended under the MLI will need to open discussions with the relevant tax authorities sooner rather than later.

How will the MLI change dispute resolution procedures under Irish DTTs?

The MLI will update provisions relating to mutual agreement procedures ("**MAP**") included in Irish DTTs. In particular the new provisions will establish timelines within which a MAP can be requested, will permit the taxpayer to submit a request for MAP to either jurisdiction and confirm that domestic time limits cannot preclude a resolution reached under MAP from being implemented.

Mandatory binding arbitration will also be introduced as a resolution mechanism that the taxpayer can instigate if a MAP fails to provide a resolution after two years. The arbitration provisions included in the MLI permit a lot of flexibility to the countries wishing to adopt them. As such, a degree of further bilateral negotiation will be required between Ireland and other jurisdictions adopting the arbitration provisions. So far, Ireland has confirmed that it is flexible on the method of arbitration that is adopted (final best offer ('baseball style') or reasoned opinion). Ireland supports arbitration being available wherever possible except where:

- the issue has been decided by a court or tribunal of either country;
- the case involves the application of domestic anti-abuse rules; or
- the taxpayer may be liable to penalties as a result of deliberate behaviour.

When will the changes become effective?

That depends. A number of criteria must be satisfied under the MLI before the changes can take effect. First, a minimum number of countries must ratify the MLI before it can enter into force and a three month waiting period must expire. Next, once both countries have ratified the MLI a further three month waiting period must expire before the MLI can enter into force between those two countries.

In addition, once the MLI enters into force a further waiting period must expire before the changes made under the MLI become effective to amend a DTT. Those waiting periods differ for withholding tax provisions and all other provisions:

- the changes become effective for withholding tax provisions on the first day of the calendar year that begins after the MLI enters into force between two countries – at the very earliest, this would be 1 January 2019 for Ireland's DTTs; and
- the changes become effective for all other provisions for taxable periods beginning on or after the expiration of six months after the date the MLI enters into force between two countries – at the very earliest, this would be taxable periods beginning on or after 1 October 2018.

However, these dates depend on the MLI being ratified by Ireland in the next Finance Act (later in 2017) and being ratified by the DTT partner relatively quickly. For now, it is unclear whether the MLI will be ratified in Finance Act 2017. The Department of Finance has indicated that the Attorney General's office is currently considering a number of legal questions on the ratification of the MLI. It is possible that this could delay Irish ratification until after 2017.

What should taxpayers do now?

Taxpayers that claim relief under any of Ireland's DTTs should review the treatment in light of the MLI. Most reliefs will continue to be available after the MLI becomes effective, however, it is a good idea to confirm that position sooner rather than later.

If you would like further details on any aspect of the MLI, or how it applies to your institution or transactions, please speak to your usual Matheson contact or any of our Tax Partners.