The other (D)TT

The UK has signed new double tax treaties with the Isle of Man and the Channel Islands. Stuart Pibworth considers the broad implications for advisers and their clients.


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When people think of the Isle of Man (IoM), several things may come to mind: high-speed motor sport; Victorian promenades and long, sandy beaches; the Laxey wheel; cyclist Mark Cavendish; or perhaps just cats without tails. However, for tax advisers, there is often something else – well, tax of course.

The IoM, along with the other Crown dependencies of Jersey and Guernsey (the dependencies), is a jurisdiction that tax advisers often encounter. One particular oddity practitioners can face when advising on any of the dependencies is the (somewhat outdated) double taxation treaty (DTT) between each of them and the UK.

The original DTTs (the old treaties) between the UK and the dependencies came into force in the 1950s and so pre-dated the publication of the OECD model convention in 1963. As such, the outcome under those agreements may be different from one under a DTT based on the model convention. This can lead to uncertainty for taxpayers because it is not always possible to benefit from commentary and guidance on the OECD model convention (tinyurl.com/y6vqrjhd) when interpreting the old treaties.

On 2 July 2018, the UK signed new DTTs with each of the dependencies. These will come into force when each jurisdiction completes its legislative procedures and most provisions will take effect from the start of the next tax year.

The new treaties

The new treaties take account of developments arising from the OECD base erosion and profit shifting (BEPS) project, are largely identical to one another, and are consistent with the OECD model convention. The key points to note include:

- changes to the residence test;
- amendments to the approach to permanent establishments;
- new provisions addressing dividend, interest and royalty income;
- provisions relating to immovable property;
- introduction of a principal purpose test to claim treaty benefits; and
- some procedural related changes.

Key points

- New double tax treaties will have some fundamental differences from previous ones with Crown dependencies.
- New treaties are consistent with the OECD model convention.
- An ‘offshore activities’ provision is now included.
- The new treaties contain clear residence provisions with tie-breaker provisions.
- In most cases, dividends may be paid free of withholding tax in the payer jurisdiction.
- Dual residents will now be able to benefit more readily from treaty relief.

Residence

Under the old treaties:

- an individual is treated as resident in one jurisdiction if they are resident there (under that jurisdiction’s law) but not in the other jurisdiction (under that other jurisdiction’s law); or
- a corporate is resident in the jurisdiction in which its business is managed and controlled.

Practical difficulties can arise if a person is resident in both jurisdictions under applicable law (in other words is

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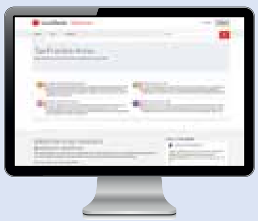


a dual resident) because there is no clear tie-breaker in the old treaties. That said, in November 2015 HMRC changed its position on corporates noting that they should, for the purposes of the old treaties, be treated as resident in the jurisdiction in which they are managed and controlled (tinyurl.com/jalpj7x).

Helpfully, the new treaties contain clear residence provisions with tie-breaker provisions.

For individuals, the tie-breaker first looks at permanent home or centre of vital interests (COVI) and then, failing determination on that basis, habitual abode. If it is not possible to determine residence on any of those criteria, it is determined by mutual agreement between the relevant tax authorities. Therefore, under the new treaties, if Bob is both UK and Manx resident (dual resident) but has his permanent home in the IoM, for the purposes of the new treaty he is resident in the IoM.

For corporates, consistent with the OECD BEPS project, the new treaties do not have a 'place of effective management' tie-breaker. Rather, they require mutual agreement between the relevant tax authorities having regard to, among other things, the place of effective management.

This welcome change should provide more certainty for taxpayers and advisers (in that the approach is more consistent with the OECD model convention), making it easier for dual residents to avail themselves of treaty benefits – including, importantly, relief from double taxation.

Permanent establishments

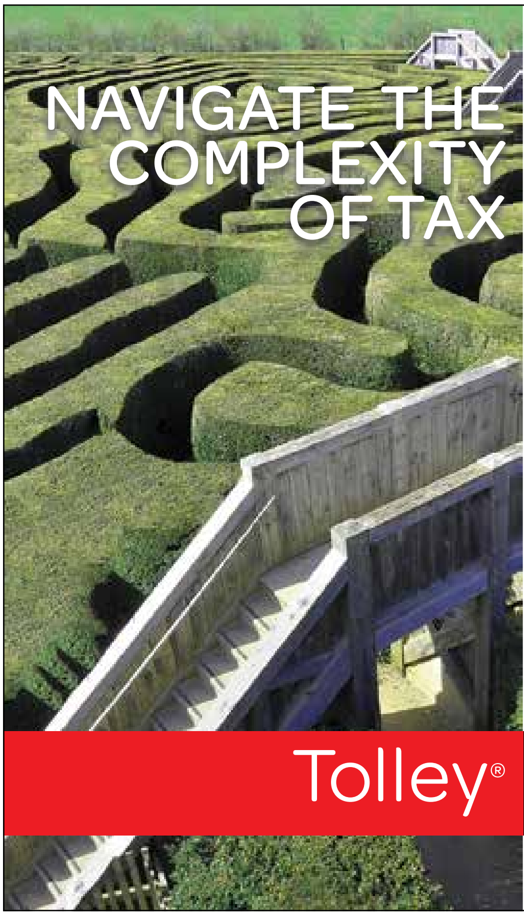
The approach to permanent establishments (PEs) and PE profit attribution in the new treaties is broadly consistent with the OECD model convention and includes the typical exclusions from the PE definition (Art 5). As for the UK's broader approach to the PE provisions in the multilateral instrument, the new treaties do not reflect the BEPS recommendations on dependent agents and specific activity exemptions, but do include anti-fragmentation provisions.

> "Consistent with the OECD BEPS project, the new treaties do not have a 'place of effective management' tie-breaker."

It is worth noting that the new treaties contain an 'offshore activities' provision. Under this, an enterprise of one jurisdiction carrying on such activities (broadly, oil and gas-related activities) in the other jurisdiction is treated as having a PE in there unless those activities are carried on for a period (or periods) not exceeding 30 days in any 12-month period. This will be of particular relevance to Jersey and Guernsey-based enterprises engaging in offshore activities because the old treaties between the UK and the two dependencies do not contain an 'offshore activities' provision.

Dividends, interest and royalties

As expected, the new treaties provide that dividends, interest and royalties paid by a resident of one jurisdiction received by a resident of the other may be taxed in the second jurisdiction.



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As long as the recipient of the dividend is the beneficial owner, it may be paid free of withholding tax in the payer jurisdiction except in some circumstances when the dividend is paid out of income (including gains) derived directly or indirectly from immovable property. In that case, any withholding tax is capped at 15% except for payments to pension schemes, in which case the dividend may be paid free of withholding tax.

The UK applies dividend withholding tax in very limited circumstances – for instance, distributions from UK real estate investment trusts (REITs) – but, when it does, the capping at 15% may be beneficial and mitigate the UK tax leakage on dividends from the UK.

Interest may be paid free of withholding tax if the beneficial owner of the interest is, among others:

- an individual;
- a company whose principal class of shares are substantially and regularly traded on a recognised stock exchange;
- a company that is owned less than 25% by residents of another jurisdiction;
- a pension scheme;
- a bank or building society; and
- specific other persons at the discretion of the relevant tax authorities.

> “If a Manx resident receives interest from the UK, the mainland payer could make the payment free of withholding on account of UK tax.”

A similar approach is adopted for withholding tax on the payment of royalties.

This is a helpful change. Accordingly, under the new treaties, if, say, Sylvia, a Manx resident, receives interest from the UK, the mainland payer could make the interest payment free of withholding on account of UK tax – subject to completion of procedural formalities.

Immovable property

How the new treaties address gains arising on the direct and indirect alienation of immovable property is consistent with the approach under the old treaties. Therefore:

- any gain derived by a resident of one jurisdiction on the alienation of immovable property in the other jurisdiction may be taxed in the second jurisdiction; and
- any gain derived by a resident of one jurisdiction from the alienation of shares deriving more than 50% of their value directly or indirectly from immovable property in the other jurisdiction may be taxed there (other than some listed shares).

Planning point

Under the new double taxation treaties, and subject to procedural formalities, if a Manx resident receives interest from the UK, the mainland payer could pay this free of withholding on account of UK tax.

Similarly, income derived by a resident of one jurisdiction from immovable property in the other may be taxed in that other jurisdiction. This approach is unsurprising. The effect is that the new treaties would not provide relief from UK tax if, say, a Guernsey resident receives rental income from UK real estate or, in some cases, a Jersey resident – directly or indirectly (from 6 April 2019 in the case of UK non-residential property) – disposes of UK real estate.

Principal purpose test

Consistent with the UK’s preferred approach to counter perceived treaty abuse, the new treaties contain a principal purpose test (PPT). Its effect is that a benefit will be denied if it is reasonable to conclude that obtaining the benefit was one of the principal purposes of any arrangement or transaction that resulted (directly or indirectly) in that benefit. This is unless it is possible to establish that the granting of the benefit in the circumstances would be in accordance with the object and purpose of the relevant provision.

At this stage, how the PPT will be applied in practice under the new treaties – and any of the UK’s post-BEPS DTTs – is uncertain.

Procedural matters

As well as the substantive provisions noted above, the new treaties contain important procedural-related provisions that should not be overlooked.

Perhaps most significantly, the combination of the residence and the elimination of double taxation provisions will allow dual residents to benefit more readily from treaty relief – namely, the elimination of double taxation through the treaty credit or exemption mechanics.

The new treaties also provide that dividends received by a UK corporate will be exempt from UK tax if the applicable UK conditions for relief are satisfied.

In terms of other points to note:

- the mutual agreement procedures have been updated; and
- there are provisions to address non-discrimination and assistance in collection of taxes.

Conclusion

There may well be some who would be in a more advantageous position under the old treaties than under the new ones, but overall this should be outweighed by the certainty provided by the latter and the ability of dual residents to benefit more readily from treaty relief.

Author details

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