
Revised tax treatment of interest income and of royalty income, with effect from 1 January 2017, under the terms of the Ireland-Chile Double Taxation Convention 2005

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Introduction

This manual explains the revision of the tax treatment of interest income and of royalty income under the terms of the Ireland-Chile Double Taxation Convention (DTC) 2005.

Ireland's DTC with Chile came into effect on 1 January 2009. It contains a provision whereby the tax treatment of interest income and of royalty income under the Convention are revised in the event of more favourable terms being agreed subsequent to 1 January 2009 by Chile with another OECD country. Chile has agreed such terms with Japan and those terms are now to apply to the Ireland-Chile DTC with effect from 1 January 2017.

The net result of the revisions is that the withholding tax rate on interest payments is reduced from 15% or 5% to 4% in certain circumstances and the withholding tax on royalty payments for the use of, or the right to use, any industrial, commercial or scientific equipment is reduced from 5% to 2%. The changes became effective from 1 January 2017.

1 Background

- 1.1. Ireland's Double Taxation Convention with Chile (the DTC) was signed on 2 June 2005 and came into effect on 1 January 2009.
- 1.2. Article 11 of the DTC concerns the taxation of interest income and Article 12 of the DTC concerns the taxation of royalty income.
- 1.3. In both Articles, source state taxation (i.e. withholding tax) is provided for. Paragraph 2 of the Interest Article provides that the State of source may tax the interest payment at a rate of 5% or 15%, depending on the payment type. Paragraph 2 of the Royalties Article provides that the State of source may tax the royalty payment at a rate of 5% or 10%, depending on the payment type.
- 1.4. The DTC has a Protocol entitled **"With reference to paragraph 2 of Article 11 and paragraph 2 of Article 12"**, which provides that, if subsequent to the entering into force of the DTC, Chile agrees better terms for interest or for royalties in a treaty with an OECD member, those better terms automatically apply to the Ireland-Chile DTC, if the same conditions are met. This type of provision is commonly referred to as a "Most Favoured Nation" clause, or MFN.

- 1.5. Chile has now informed Revenue that the MFN conditions have been fulfilled. Chile signed a treaty with Japan (an OECD member) which is effective from 1 January 2017. This treaty has lower source tax rates for interest and for royalties than those contained in the Ireland-Chile DTC. Under the terms of the MFN, the tax rates in the Ireland-Chile DTC should automatically be replaced by the tax rates provided under the Chile-Japan treaty where the same circumstances apply as are specified in the Chile-Japan treaty.

2 Revised tax treatment for Interest with effect from 1 January 2017

- 2.1 Article 11(2) of the Ireland-Chile DTC provides for interest withholding tax rates of 5% and 15%. Effective from 1 January 2017, Article 11 and Protocol 6 of the Chile-Japan treaty provides that interest payments are subject to withholding tax at rates of 4% (under certain circumstances) and 15%. As a result of the paragraph of the Protocol in the Ireland-Chile DTC entitled **“With reference to paragraph 2 of Article 11 and paragraph 2 of Article 12”**, the 5% and 15% tax rates in Article 11(2) of the Ireland-Chile DTC will be replaced by a 4% rate where the same circumstances apply as are specified in the Chile-Japan treaty.
- Loans granted by banks and insurance companies (Article 11(2)(a)(i) of the Ireland-Chile DTC) and credit sales of machinery and equipment (Article 11(2)(a)(iii) of the Ireland-Chile DTC) may be eligible for the 4% rate instead of the existing rate of 5%. However, if the interest is paid as part of an arrangement such that the conditions for meeting the 4% rate do not apply, the rate will stay at 5%.
 - Interest derived from bonds or securities traded on a securities market (Article 11(2)(a)(ii) of the Ireland-Chile DTC) is not affected and remains subject to 5% withholding tax.
 - Certain enterprises that are subject to the 15% rate (Article 11(2)(b) of the Ireland-Chile DTC) may also be eligible for the 4% rate, if the relevant conditions are met (e.g. if the interest is not paid as part of an arrangement involving back-to-back loans, as set out in Article 11(4) of the Chile-Japan treaty). If the relevant conditions are not met, such enterprises will be subject to a rate of 10% (instead of the existing rate of 15%).

- 2.2 A further change will apply from 1 January 2019, when the 15% withholding tax rate in the Chile-Japan treaty is reduced to 10%. The 15% rate in the Ireland-Chile DTC (Article 11(2)(b)) will automatically reduce to 10% on the same day (1 January 2019), in accordance with the provisions of the DTC.
- 2.3 In summary, the 4% rate (and in some cases, the 10% rate) will apply instead of the existing rates only if the qualifying conditions set out in the Chile-Japan treaty also apply in the case of the Ireland-Chile DTC. Revenue's interpretation of the way in which Article 11(2) of the Ireland-Chile DTC should be read to incorporate the Chile-Japan conditions is included at Annex 1 and Annex 2 of this manual. Annex 3 contains an unofficial translation of the relevant provisions of the Chile-Japan treaty.

3 Revised tax treatment for royalties with effect from 1 January 2017

- 3.1 Article 12(2) of the Ireland-Chile DTC provides for royalty withholding tax rates of rates of 5% (for the use of, or the right to use any industrial, commercial or scientific equipment) and 10% in other cases. Effective from 1 January 2017, Article 12(2) of the Chile-Japan treaty provides for withholding taxes on royalty payments of 2% for the use of, or the right to use, industrial, commercial or scientific equipment and 10% in other cases. As a result of the paragraph of the Protocol in the Ireland-Chile DTC entitled "**With reference to paragraph 2 of Article 11 and paragraph 2 of Article 12**", the 5% tax rate in Article 12(2) of the Ireland-Chile DTC in respect of payments for the use of, or the right to use, industrial, commercial or scientific equipment is replaced by a 2% rate from 1 January 2017.

4 Annexes on Revenue's interpretation and unofficial translation of Chile-Japan treaty text

Annex 1 – Revenue's interpretation (agreed with the competent authority in Chile) as to how Article 11(2) of the Ireland-Chile DTC should be read in order to apply the Most Favoured Nation (MFN) provision, effective from 1 January 2017

In accordance with the Protocol in the Ireland-Chile DTC entitled **“With reference to paragraph 2 of Article 11 and paragraph 2 of Article 12”**, paragraph 2 of Article 11 of the Ireland-Chile DTC is to be read as follows, effective from 1 January 2017:

“2. However, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed:

- (a) 4 per cent on the gross amount of the interest if the beneficial owner of the interest is either:
 - (i) a bank;
 - (ii) an insurance company;
 - (iii) an enterprise substantially deriving its gross income from the active and regular conduct of a lending or finance business involving transactions with unrelated persons, where the enterprise is unrelated to the payer of the interest. For the purposes of this clause, the term “lending or finance business” includes the business of issuing letters of credit, providing guarantees or providing credit card services;
 - (iv) an enterprise that sells machinery or equipment where the interest is paid with respect to indebtedness arising as part of the sale on credit of such machinery or equipment; or
 - (v) any other enterprise, provided that in the three taxable years preceding the taxable year in which the interest is paid, the enterprise derives more than 50 per cent of its liabilities from the issuance of bonds in the financial markets or from taking deposits at interest, and more than 50% of the assets of the enterprise consist of debt claims against unrelated persons;
- (aa) 5 per cent of the gross amount of the interest derived from bonds or securities that are regularly and substantially traded on a recognized securities market;
- (b) 15 per cent of the gross amount of the interest in all other cases.

For the purposes of subparagraph (a), an enterprise is unrelated to a person if the enterprise does not have with the person a relationship described in subparagraph (a) or (b) of paragraph 1 of Article 9.

Notwithstanding the provisions of paragraph (a), if interest referred to in that subparagraph is paid as part of an arrangement involving back-to-back loans or other arrangement that is economically equivalent and intended to have a similar effect to an arrangement involving back-to-back loans, such interest may be taxed in the Contracting State in which it arises, but the tax so charged shall not exceed 10 per cent of the gross amount of the interest in cases provided in subparagraphs (iii) and (v) of the aforementioned subparagraph; and it shall not exceed 5 per cent of the gross amount of the interest in cases provided in subparagraphs (i), (ii) and (iv) of the same subparagraph.

It is understood that the term “arrangement involving back-to-back loans” would cover, inter alia, any kind of arrangement structured in such a way that a financial institution which is a resident of a Contracting State receives interest arising in the other Contracting State and the financial institution pays an equivalent interest to another person which, if the person received the interest directly from the other Contracting State, would not be entitled to limitation of tax under subparagraph (a) with respect to that interest in that other Contracting State.”.

Annex 2 – Revenue’s interpretation (as agreed with the competent authority in Chile) as to how Article 11(2) of the Ireland-Chile DTC should be read in order to apply the Most Favoured Nation (MFN) provision, effective from 1 January 2019

In accordance with the Protocol in the Ireland-Chile DTC entitled “**With reference to paragraph 2 of Article 11 and paragraph 2 of Article 12**”, paragraph 2 of Article 11 of the Ireland-Chile DTC is to be read as is outlined in Annex 1 above, but with the following subparagraph substituted for paragraph 2(b) of that text:

“(b) 10 per cent of the gross amount of the interest in all other cases.”

Annex 3 – Unofficial translation of the relevant provisions of the Chile-Japan treaty

Article 11, paragraphs 2, 3 and 4 of the Chile-Japan treaty:

“2. However, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that Contracting State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed:

- (a) 4 per cent on the gross amount of the interest if the beneficial owner of the interest is either:
- (i) a bank;
 - (ii) an insurance company;
 - (iii) an enterprise substantially deriving its gross income from the active and regular conduct of a lending or finance business involving transactions with unrelated persons, where the enterprise is unrelated to the payer of the interest. For the purposes of this clause, the term “lending or finance business” includes the business of issuing letters of credit, providing guarantees or providing credit card services;
 - (iv) an enterprise that sells machinery or equipment where the interest is paid with respect to indebtedness arising as part of the sale on credit of such machinery or equipment; or
 - (v) any other enterprise, provided that in the three taxable years preceding the taxable year in which the interest is paid, the enterprise derives more than 50 per cent of its liabilities from the issuance of bonds in the financial markets or from taking deposits at interest, and more than 50% of the assets of the enterprise consist of debt claims against unrelated persons;
- (b) 10 per cent of the gross amount of the interest in all other cases.

For the purposes of subparagraph (a), an enterprise is unrelated to a person if the enterprise does not have with the person a relationship described in subparagraph (a) or (b) of paragraph 1 of Article 9.

3. For a period of two years from the date on which the provisions of paragraph 2 of this Article shall be applicable in accordance with the provisions of paragraph 2 of Article 29, the rate of 15 per cent shall apply in place of the rate provided in subparagraph (b) of paragraph 2 of this Article.

4. Notwithstanding the provisions of subparagraph (a) of paragraph 2, if interest referred to in that subparagraph is paid as part of an arrangement involving back-to-back loans or other arrangement that is economically equivalent and intended to have a similar effect to an arrangement involving back-to-back loans, such interest may be taxed in the Contracting State in which it arises but the tax so charged shall not exceed 10 per cent of the gross amount of the interest.”.

Protocol number 6 of the Chile-Japan treaty:

“6. It is understood that the term “arrangement involving back-to-back loans” would cover, inter alia, any kind of arrangement structured in such a way that a financial institution which is a resident of a Contracting State receives interest arising in the other Contracting State and the financial institution pays an equivalent interest to another person which, if the person received the interest directly from the other Contracting State, would not be entitled to limitation of tax under subparagraph (a) of paragraph (2) of Article 11 of the Convention with respect to that interest in that other Contracting State.”.