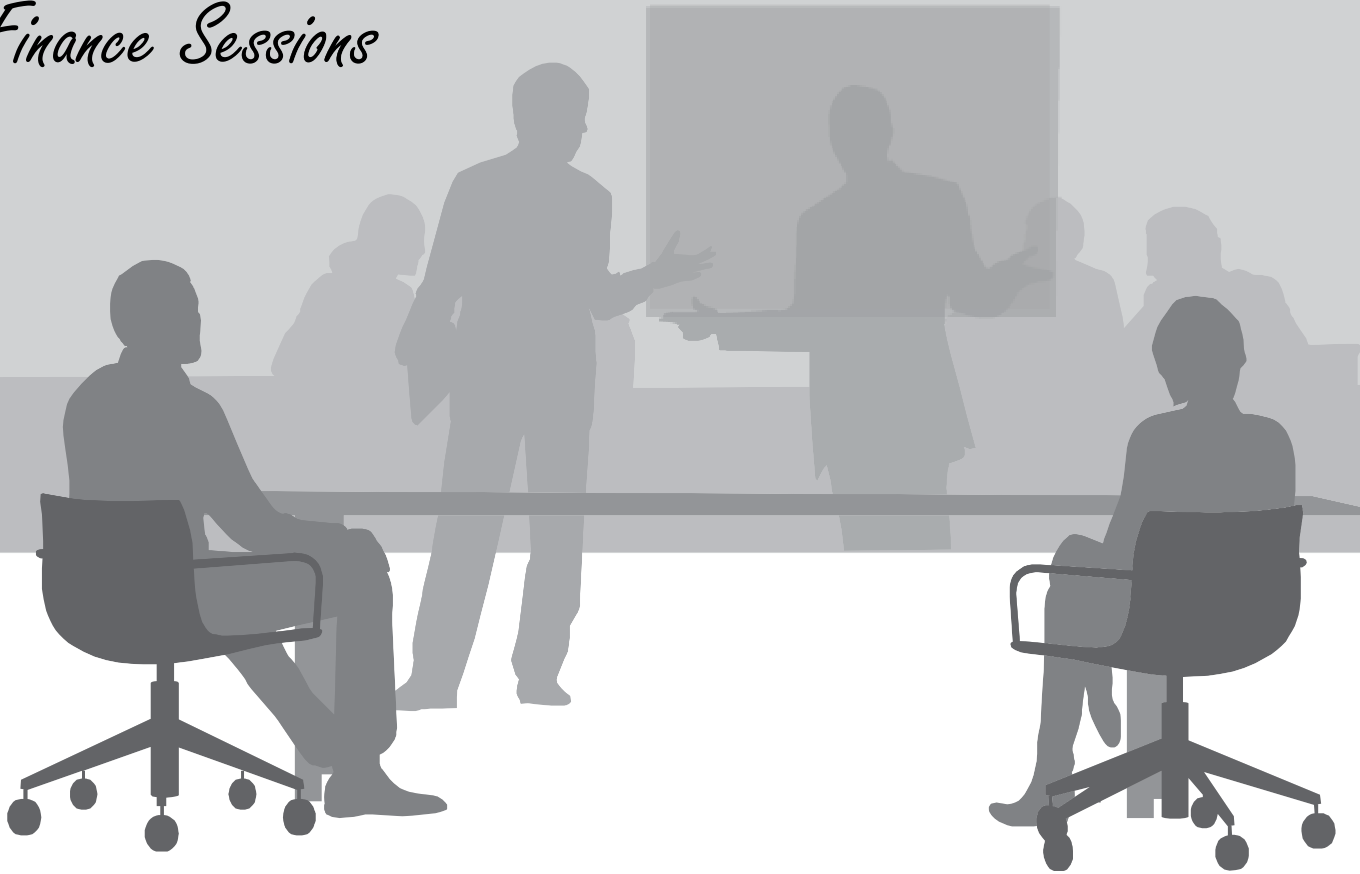
Public Finance Sessions



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Public Finance

International Taxation

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Topics

- International double taxation - how it arises
- Connecting factors
- Unilateral relief provisions
- Double taxation alleviation agreements
- Tax Havens.

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International double taxation

Arises when

- Cross-border investment occurs
- Resident of one country owns income-producing property in other countries
- Capital gains of overseas property

Tax claims Home vs Host

- Home country seeks to tax profits accruing to its citizens or companies from other countries
- Host country seeks to tax profits arising from sources within it.
- International double taxation inhibits cross border investment.

Double taxation example

HQ in USA

- has to pay tax on its worldwide income,

  (Residence taxation)

Branch in India

- also has to pay tax for its local income in India

  (Source taxation)

ends up paying tax twice for income generated in India

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Connecting factors

Connecting factors

Factors that create exposure to taxation of other countries:

- Residence
- Permanent Establishment
- Cross-border transactions.

Trading with vs Trading in

- Trading with
  - company engaged in selling in another country without establishing presence there,
  - does not attract tax.
- Trading in
  - company tries to develop the market by establishing a presence.
  - attracts tax liability

Residence factor

Tax liability arises

- When the entity is a resident in that country, or
- When the source of his income arises in that country.

Country practices differ

- Some countries tax a resident on world-wide income basis, (UK)
- Others tax only if the income arises or received within their territorial limits (erstwhile Hongkong)
  - irrespective of the origin of the entity.

Two criteria for Residence

- Incorporation criterion
- Concept of management and control.

Incorporation criterion

- Companies incorporated (registered) in the jurisdiction is treated as resident for tax purpose
  - For example, US, UK
- Companies whose management and control is exercised from the jurisdiction irrespective of the place of incorporation
  - Ireland
- Double taxation possibility because of difference in the criteria

Tie-Breaker ' Rules

- Determine a single residence for tax treaty purposes, in cases where a person/ company is a resident under the domestic tax laws of both treaty States.
    - OECD Model Tax Convention, at para 3 for companies,
- Can happen when the two States apply different tests for residency.

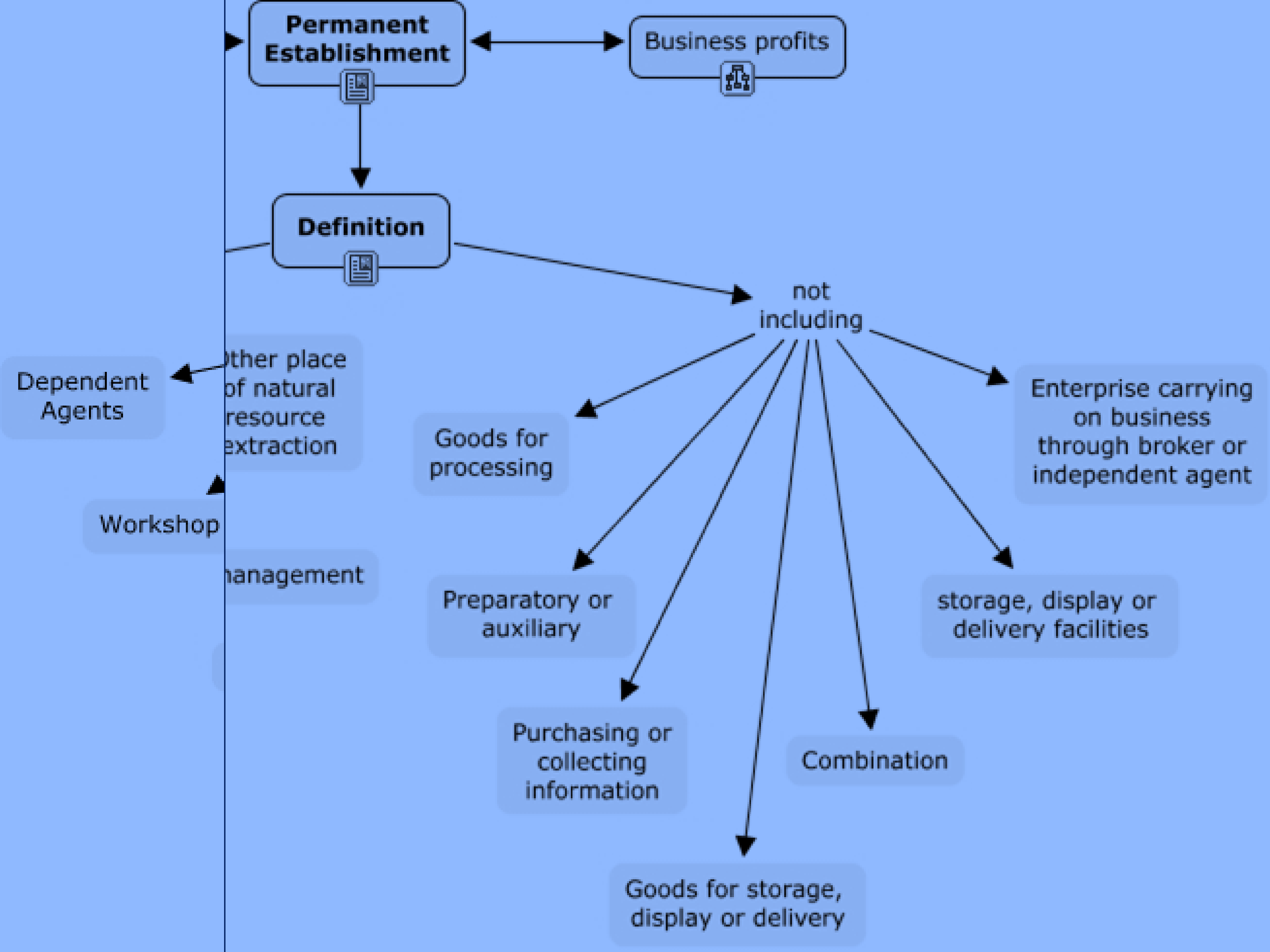
Residence concept in India

- A company incorporated in India is its ordinary resident (incorporated in India)

  [S 6(3) of Income-tax Act, 1961].
- Or, if the control and management of which is situated wholly in India during any year

The PE factor

- Place of relative permanence from where the foreign enterprise carries on business on the host soil.
- Most controversial
- Tax planners try to show that PE doesn't exist.


Permanent Establishment
Business profits
Definition
not including
Dependent Agents
ther place of natural resource extraction
Workshop
nanagement
Goods for processing
Preparatory or auxiliary
Purchasing or collecting information
Goods for storage, display or delivery
Combination
storage, display or delivery facilities
Enterprise carrying on business through broker or independent agent

Force of attraction rule

- If the foreign enterprise also carries on the same or similar business independent of the PE, the income attributable to such activity is also deemed to belong to the PE.

PE in India

- No PE concept in the Income Tax Act 1961
- More of a convention
- Court rulings consider the concept of 'business connection'
  - 100% subsidiary, branch, factory, agency are PEs.
  - Casual and isolated nature not PE.

Two broad categories:

- Foreign technical collaborations into India,
  - technical expertise, know-how, engineering services, supply of capital goods.
- Foreign financial collaborations
  - consist of funding and investment.

Types of Overseas income

- Foreign technical collaborations generate
  - Royalties, technical fees, license fees for patents, copyrights or trademarks
- Foreign financial collaborations
  - Profits, dividends, interest, capital gains.

Unilateral double tax relief measures

Methods of relief

- Adopted pending complete harmonization
- Territorial principle - Exemption method
  - Home country voluntarily forgoes the taxing rights by granting exemption.
  - Simpler computations
- World-wide income principle -Tax credit method
  - taxes paid in the host country are given a credit while assessing the worldwide income in the home country.

Exemption vs Credit method

Foreign tax < Domestic tax

		Exemption	Credit
Total income		200	200
Income arising in an overseas subsidiary		100	100
Foreign tax liability of the host country at	40%	40	40
Income assessed for domestic tax		100	200
Domestic tax liability	60%	60	120
Credit for the overseas tax		0	-40
Net domestic tax liability		60	80
Total tax		100	120
Net income after tax		100	80

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Exemption vs Credit method

Foreign tax > Domestic tax

		Exemption	Credit
Total income		200	200
Income arising in an overseas subsidiary		100	100
Foreign tax liability of the host country at	60%	60	60
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Domestic tax liability	40%	40	80
Credit for the overseas tax		0	-60
Net domestic tax liability		40	20
Total tax		100	80
Net income after tax		100	120

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Exemption vs Credit method

Foreign tax restricted to Domestic tax (India follows this method S 91)

		Exemption		Credit	
Total income			200		200
Income arising in an overseas subsidiary		100		100	
Foreign tax liability of the host country at	60%	60		60	
Income assessed for domestic tax		100		200	
Domestic tax liability	40%	40		80	
Credit for the overseas tax (limited to 40%)		0		-40	
Net domestic tax liability		40		40	
Total tax			100		100
Net income after tax			100		100

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Tax system incompatibilities

- Direct – Indirect Tax mix
  - Higher indirect taxes means high business costs and low gross profits
  - Higher direct taxes means the opposite.
- Direct tax system incompatibility
  - Classical vs Imputation system across the countries.
  - Effect of tax incentives
- 'Tax sparing provisions'
  - Respecting the host country's tax incentives and rebates.

Double Tax Avoidance Agreements

- Protect tax-payers against double taxation and prevent tax hurdles in the free flow of international trade, investment and transfer of technology.
- Prevent discrimination between the tax-payers in the international field
- Provide legal and fiscal certainty
- Facilitate mutual exchange of information and reducing litigation by providing for mutual assistance procedure.

Several Models

- OECD Model 1961
- UN Model , 1968, 1972
- US Model
- Andean Model
- India and the DTAAs
  - Section 90 of the Income Tax Act,
  - Section 90A

Tax Havens

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What is a tax haven?

A state or a country where certain taxes are levied at a low rate or not at all while offering due process, good governance and a low corruption rate.

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Early times

- Ancient Greece
- American colonies traded from Latin American countries

Different types

- No tax:
  - Bahamas, Bermuda, Cayman Islands,
- Low tax:
  - Mauritius, Hong Kong, British Virgin Islands, Isle of Man, Channel Islands
- Special facilties:
  - Switzerland.

LOCATIONS IN OFFSHORE TAX JURISDICTIONS

When you hear "tax haven" you probably picture a small island with great weather and accommodating tax and banking systems. While you wouldn't be entirely wrong, you'd only be seeing part of the picture. The IMF identifies over 60 'offshore financial centres' around the world, some of which you might find surprising...

COUNTRY | CITY | ISLAND/POLITICAL REGION

12 EUROPE
ANDORRA
CYPRUS
LIECHTENSTEIN
LUXEMBOURG
MALTA
SWITZERLAND
DUBLIN
LONDON
GUERNSEY
HELIGOLAND
ISLE OF MAN
JERSEY

2 NORTH AMERICA
US, DELAWARE
BERMUDA

3 MIDDLE EAST
BAHRAIN
ISRAEL
LEBANON

8 ASIA
JAPAN
PHILIPPINES
SINGAPORE
THAILAND
HONG KONG
LABUAN, MALAYSIA
MACAU
PALAU

19 CENTRAL AMERICA & CARIBBEAN
BAHAMAS
BARBADOS
BELIZE
COSTA RICA
DOMINICA
GRENADA
PANAMA
ST KITTS AND NEVIS
ST LUCIA
ST VINCENT AND THE GRENADINES
ANGUILLA
ANTIGUA
ARUBA
BRITISH VIRGIN ISLANDS
CAYMAN ISLANDS
MONTSERRAT
NETHERLANDS ANTILLES
PUERTO RICO
TURKS AND CAICOS

1 SOUTH AMERICA
URUGUAY

5 AFRICA
DJIBOUTI
GHANA
MAURITIUS
SEYCHELLES
TANGIER

11 OCEANIA
MARSHALL ISLANDS
MICRONESIA
NAURU
NEW ZEALAND
NIUE
SAMOA
VANUATU
COOK ISLANDS
GUAM
MARIANAS
TAHITI

Methods

- Holding co method
- Transfer-pricing
- Thin capitalization
- Treaty shopping

Thank you!

"Oh, we're not invading or anything.
We're just looking for a tax shelter"