LAW PUNDITS

# DOUBLE TAXATION

Course Material

**Double taxation**

## The concept and types of double taxation

Double taxation occurs where two or more countries tax the same income, gains or profits. There are two ways in which double taxation may arise: juridical double taxation; and economic double taxation.

**Juridical double taxation:** Where tax is levied on a person in more than one jurisdiction, for example:

Income tax: UK domestic legislation generally provides that all income which arises in the UK, whether derived by a UK resident or not (eg rental income), and income derived from abroad by a UK resident (eg income from employment abroad) is chargeable to UK tax.

When other countries adopt the same approach the same income could be taxed both in the country where the income arises and in the country in which the recipient resides

**Chargeable gains**: In general, the UK taxes its residents to Capital Gains Tax (CGT) on all gains wherever they arise but non-residents are normally not chargeable to CGT, apart from in certain circumstances

When other countries tax capital gains arising in their countries to both their residents and to non-residents, the gain could be taxed twice.

**Economic double taxation:** Where the same income suffers tax in two locations but by different taxpayers. For example, if a UK company has a subsidiary in Denmark, the subsidiary will pay Danish tax on its profits. If those profits are remitted to the UK parent, by way of dividend they may be taxed again in the hands of the UK company, if the dividend exemption does not apply.

## Double taxation agreements and unilateral relief

In order to mitigate double taxation, the most nations would have entered into a large number of double taxation agreements (‘DTA’), known alternatively as a double taxation treaty or convention, to reduce the incidence of double taxation. In addition, most of the countries have legislation to provide unilateral double taxation relief in certain situations where no DTA relief is available.

A list of territories with which a country has a current DTA and a guide to possible entitlement to double taxation relief for certain types of incomes received by the residents of each of these territories can be found in the double taxation treaties and most of these treaties are publicly available documents.

In relation to double tax relief, the objectives of international tax planning are typically to:

1. identify the amount of overseas tax which is creditable under a DTA or as unilateral relief

2. identify the amount of home country tax against which the overseas tax can be credited, and also the income on which these arise

3. maximise relief by efficient utilisation of losses

**Double taxation agreements**

The objectives of a DTA are reflected in the title of the DTA. The UK/US DTA for instance is entitled:

'Convention between the government of the United Kingdom of Great Britain and Northern Ireland and the government of the United States of America for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital gains.'

**The objectives of a DTA generally are**:

1. Avoidance of double taxation: The first objective of a DTA is to relieve juridical (and occasionally economic) double taxation as described above. This is important as it allows businesses to conduct international trade with a degree of certainty as to where and how they will be taxed and without incurring disproportionate tax liabilities. Relieving double taxation is a means of removing barriers to international trade, to the operation of free and open markets and to the free movement of persons and of capital

2. Prevention of fiscal evasion: Some DTAs have provisions that allow countries to exchange information on taxpayers. For example, HMRC frequently uses the provisions of DTAs to obtain access to details of funds held by UK residents in overseas bank accounts

**Unilateral relief**

Unilateral credit relief may be granted against UK taxes as well as several other jurisdictions in respect of foreign taxes imposed in a country with which the UK has no DTA. Broadly speaking, unilateral relief is limited to the amount of relief that would be due if a DTA were in existence.

Unilateral relief is only due in respect of taxes which are charged on income or chargeable gains, and which correlate with UK income tax, corporation tax or tax on chargeable gains. Under section 9(6) of the Taxation (International and Other Provisions) Act 2010 (TIOPA 2010), credit may also be granted for taxes payable under the law of a province, state or other part of a country or which are levied by or on behalf of a municipality or other local body, provided that such taxes are charged on income.

Unilateral relief is not allowed in the following circumstances:

1. where a double taxation treaty would allow relief in respect of the foreign tax in question, or

2. where the taxpayer is not a UK resident, or

3. where the taxpayer elects for the credit not to be allowed

**Implementation of DTAs**

Under the law of some jurisdictions, a DTA becomes effective automatically when the DTA comes into force. Other jurisdictions require parliamentary or other approval before the DTA becomes part of domestic law.

It is important to mention that a DTA cannot impose a UK tax charge if one does not exist under domestic law. For example, as mentioned above, non-residents in the UK are not generally charged capital gains tax and a DTA cannot be used to impose a charge under UK domestic law. Therefore, unless tax arises under UK domestic law, there is generally no need to consider the DTA. However, overseas jurisdictions may use the DTA as the basis for imposing a charge to tax.

Where a DTA applies, there are two main methods of relieving the tax:

1. Exemption: Income or gains are exempted from tax in the country where the income or gains arise; exemption may also be given in the country of the recipient's residence

2. Credit: Where the income or gains are taxed in both countries, the country in which the recipient is resident gives credit for the other country's tax against its own tax (for UK residents, relief from double taxation is usually achieved by the credit method)

Where income remains taxable in both countries, the country in which it arises may agree, under a DTA, to tax it at a lower rate than its normal domestic rate. That is usually the case with dividends, interest and royalties. The country in which the recipient is resident gives credit against its own tax for the reduced amount of tax paid in the other country.

Where relief is not given under an agreement, the UK gives credit unilaterally to UK

**Scope of a DTA**

Scope of a DTA:

1. **Jurisdiction**: DTAs generally only apply to the territories (each usually referred to as the Contracting State), which have signed the agreement. In the case of countries

which cease to exist, the DTA may remain in force and cover the new country or countries which come into existence as a result

2. **Dates in force**: DTAs will apply from a particular date, which is generally set out in the 'Entry into force' article. This may be subject to specific processes in one or both of the Contracting States, for example parliamentary approval

3. **Taxes covered**: A DTA will set out the taxes which are covered usually within Article 2. Not all taxes are covered, in particular, inheritance tax is not generally covered by the UK's DTAs. Separate DTAs are usually concluded to deal with inheritance tax

For example, Article 2(3) of the UK/US DTA provides that:

In the case of the US:

1. the Federal income taxes imposed by the Internal Revenue Code (but excluding social security taxes), and

2. the Federal excise **taxes** imposed on insurance policies issued by foreign insurers and with respect to private foundations

In the case of the United Kingdom:

1. the income tax

2. the capital gains tax

3. the corporation tax, and

4. the petroleum revenue tax

The DTA does not therefore cover state taxes, although these may qualify for unilateral relief in the UK.

Article 2(4) of the UK/US DTA provides that the Convention will apply to any identical, substantially similar taxes or taxes put in place of the existing taxes imposed after the Convention is in force.

**Residence**: The benefit of a DTA can normally only be claimed by a resident of one of the Contracting States. This is usually set out in Article and the DTA will also provide an explanation of how resident is defined

**Relevant article of the treaty**: Some items of income may be covered by more than one Article of a treaty. When this occurs there should be an order of priority set out in the DTA.

For example, there could be a situation where royalties could be treated as business income, technical service fees and royalties

**General anti-avoidance provisions**: The DTA may include general anti-avoidance provisions which restrict its application. These are typically limitations on benefit provisions, which if not satisfied will prevent the DTA from applying to any income

**Specific anti-avoidance provisions**: Specific anti-avoidance provisions may be included in the Articles of a DTA, which prevent that particular Article from applying to a transaction or item of income, although do not affect the application of that DTA more generally. These include beneficial ownership requirements and anti-conduit rules.

**Model DTAs**

The organisation for economic co-operation and development (OECD) has, and continues to develop, standardised DTAs to harmonise DTAs between members of the OECD. Most of the countries around the world follow the OECD model, including those nations which are not themselves members of the OECD. The OECD model DTA was last updated in 2010.

The OECD has also published commentaries to the model conventions and these are a useful tool in interpreting a DTA.

There is sometimes flexibility on interpreting certain Articles of the model, and some jurisdictions have published 'reservations' to the interpretation contained in the commentary, which set out their position.

There are other model DTAs besides that of the OECD, most notably the UN model and the US model.

Many of the UK's early DTAs (before the agreement of the OECD model) follow a very different pattern to the OECD model. These are typically with former colonies, and are often referred to as the 'colonial' treaties, although there are still some non-OECD model DTAs with jurisdictions elsewhere, including European countries.

Interpretation of DTAs

1. OECD commentary: Many jurisdictions follow the OECD commentary in most cases, even when the OECD commentary was published after the tax treaty came into force

2. Case law: There have been some tax cases which deal with the interpretation of DTAs, with the principles established in cases including *CIR v Commerzbank AG* (1990) 63 TC 218 being summarised in *Memec Plc v IRC* as follows:

   ◦ the approach should be purposive

   ◦ it should be international, not exclusively English

◦ it should have regard to Article 31(1) of the Vienna Convention

◦ recourse may be had to supplementary means of interpretation such as travaux preparatoires (the record of negotiations of a treaty)

◦ subsequent commentaries and decisions of foreign courts have persuasive value only

◦ recourse to travaux preparatoires, international case law and the writings of jurists is discretionary, not mandatory. The Court of Appeal has recognised the official commentaries on successive versions of the OECD Model Convention as supplementary means of interpretation. See *Sun Life Assurance Co of Canada v Pearson (Inspector of Taxes) (1986).*

Exchange of Notes that clarifies the application of certain aspects of the DTA. Tax authorities may publish their own interpretation of a DTA. For example, HMRC published a Tax Bulletin on the 2001 UK/USA DTA and the US Treasury published a Technical Interpretation. The DTA was also accompanied by an Exchange of Notes.

Where changes are made to a DTA, this may either be by way of a new DTA, or issuing a Protocol to an existing treaty. The Protocol will state the date from which it applies, but it will amend the effect of an existing DTA.

**Procedure for claiming relief under a DTA**

Double taxation relief may be claimed by: individuals, corporations, partnerships, pension funds, trusts, etc, resident, incorporated or formed in countries which hasa double taxation agreement with each other.

Some DTAs have ‘country specific’ forms for use by residents of the particular DT country, for example, France.

The type of income that can be claimed for in most cases, includes:

pensions and some annuities

royalties

interest