INTRODUCTION TO INTERNATIONAL TAX LAW

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Deusto, November 2010

Introduction to International Tax Law - Agenda

- Concept and goals
- Jurisdiction
- Double taxation relief
- Tax treaties
- Transfer pricing
- Anti-avoidance measures
- EU Tax law
Introduction to International Tax Law

CONCEPT AND GOALS

- “International Tax Law” = misnomer
- Scope
  - All tax issues arising under a country’s tax laws that include a foreign element
    - Mainly income tax laws
    - Other taxes
CONCEPT & GOALS

- International (Income) tax law: two dimensions:
  - Taxation of Residents individuals and corporations on income in foreign countries (taxation of foreign income)
  - Taxation of Nonresidents on income arising domestically (taxation of nonresidents)

CONCEPT & GOALS

- Issues under income tax laws:
  - Cross-border trade in goods and services
  - Cross-border manufacturing by MNE
  - Cross-border investment by individuals or investment funds
  - Taxation of individuals who work or do business in a country other than their residence country
CONCEPT & GOALS

International tax law. Scope beyond income tax:
- Estate taxes/ Inheritance taxes
- Gift taxes
- Wealth taxes
- Sales taxes
- Customs taxes

GOALS:
- Inter-nation equity
- Promoting fairness
- Enhancing the position of the country in the world economy
- Capital-export and capital-import neutrality
CONCEPT & GOALS

- Practical issues faced by the professional:
  - Intersection domestic-foreign tax law
  - Differences in the legal systems: concepts, institutions, legal traditions, accounting principles, etc.

Introduction to International Tax Law

JURISDICTION TO TAX
JURISDICTION TO TAX

- Residence – Source
- Residence
  - Individuals
  - Legal entities
  - Treaty issues
- Source
  - Employment and Personal Services
  - Business income
  - Investment income
  - Capital gains

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JURISDICTION TO TAX

- Nexus *country* - *person* obtaining the income: *residence jurisdiction*
- Nexus *country* – *activities* generating the income: *source jurisdiction*
JURISDICTION TO TAX - Residence

- Residence of Individuals
  - Facts and circumstances. Objective manifestations of joining the economic and social life of a country:
    - Dwelling
    - Income producing activities
    - Family
    - Social ties
  - Arbitrary test: number of days of presence, e.g. 183-day test

JURISDICTION TO TAX

- Residence of Individuals (II)
  - Facts and circumstances + objective tests = presumptions to establish residence = certainty and fairness
JURISDICTION TO TAX

○ Residence of Individuals (III)
  ● Presumptions:
    ○ Individuals present in a country for 183 days in a taxable year unless they do not have a dwelling and are not citizens
    ○ Individuals having a dwelling unless they also have a dwelling in another country
    ○ Citizens unless they have a dwelling abroad and are outside more than 183 days
    ○ Individuals cannot relinquish residence until residence in another country

JURISDICTION TO TAX

○ Residence of legal entities
  ● Corporations:
    ○ Place of Incorporation
    ○ Place of (Effective) Management
    ○ Residence of the shareholders
  ● Other legal entities:
    ○ Place of organization
    ○ Place of management
JURISDICTION TO TAX

○ Treaty issues
  ● Art. 4(1) OECD MC:
    ● (...) the term resident of a Contracting state means any person who, under the laws of that State, is liable to tax therein by reasons of his domicile, residence, place of management or any other criterion of a similar nature (...)
JURISDICTION TO TAX

- Residence of legal entities
  - Art. 4(3) OECD MC: Legal entities residence: POEM.
  - Other tie-breaker rules:
    - Place of Incorporation
    - Dual resident = not resident in either country

JURISDICTION TO TAX – Source

- International custom:
  - A country has the primary right to tax income that has its source in that country
  - Country of residence expected to provide relief from double taxation if its residence jurisdiction overlaps the source jurisdiction of another country
JURISDICTION TO TAX – Source

- What is “source”?
- Most countries: vague rules (esp. for business income)
- Most tax treaties do not include explicit source rules for business income
- OECD MC vs UN MC: limitation of source jurisdiction

Employment and Personal Services

- Source country = where services are performed
- If several countries = allocation based on the time performing in each country
JURISDICTION TO TAX - Source

- Employment and Personal Services (II)
  - Limit of source jurisdiction on dependent personal services income if (all requirements met):
    - Employee present in SC ≤ 183 days
    - Payment by a non-resident
    - Payment not allocated to a PE in SC

JURISDICTION TO TAX – Source

- Business Income
  - OECD and UN MC: taxable only if attributable to a PE
  - US MC: Source rule approach
JURISDICTION TO TAX - Source

Investment Income

- Investment income (dividends, interest, royalties) derived by non-residents usually taxable through WHT

- Capital gains are not usually subject to WHT

JURISDICTION TO TAX - Source

Investment Income (II). Source rules:

- Dividends and Interests: country of residence of the payer (Arts. 10 and 11 OECD and UN MC)

- Royalties: where royalties arise = typically the country providing legal protection
  - OECD MC: exclusive rights to residence country. No source rules
  - UN MC: shared taxing rights. SC = resident country of the payer (or PE)
JURISDICTION TO TAX - Source

- Investment Income (III). Shared taxing rights between RC and SC = limited WHT in the SC
- DTTs with Zero WHT
  - Assumptions:
    - Equal flow of investments
    - Tax jurisdiction of SC will be exercised by RC
  - Advantages and Disadvantages

JURISDICTION TO TAX - Source

- Capital gains
  - OECD MC: SC the residence country of the seller. Exception
    - Business property
    - Immovable property
  - UN MC: Gains for sales not specifically mentioned in the treaty maybe taxed in RC and in SC
DOUBLE TAXATION RELIEF – Concept & Types

- International (Juridical) Double Taxation:
  - The imposition of comparable direct taxes (income-wealth-inheritance) taxes
  - by two or more sovereign countries
  - on the same item (income-assets)
  - of the same taxable person
  - for the same taxable period
DOUBLE TAXATION RELIEF

- **(International) Economic Double Taxation:**
  - Multiple taxation of the same items of economic income in different taxpayers, e.g.
    - Company – Shareholder:
      - Parent company
      - Individual shareholder
    - Partnership – Partner
    - Trust - Beneficiary

DOUBLE TAXATION RELIEF

- **Three types of double taxation in relation to 3 types of conflicts:**
  - Source – Source
  - Residence – Residence
  - Residence – Source
DOUBLE TAXATION RELIEF

- Other types of conflicts:
  - Definitions of Income
  - Timing and tax accounting rules
  - Arm’s Length Prices
  - Rules to prevent tax avoidance

DOUBLE TAXATION RELIEF

- Remedies to prevent double taxation:
  - Unilateral
  - Bilateral
  - Multilateral

- The methods for relieving international taxation refer both to juridical and economic double taxation
DOUBLE TAXATION RELIEF - METHODS

- Relief mechanisms:
  - Deduction
  - Exemption
  - Credit

DOUBLE TAXATION RELIEF

- DEDUCTION Method

  - Taxation on the worldwide income of residents and deduction of the foreign taxes paid from the taxable income
DOUBLE TAXATION RELIEF

○ DEDUCTION Method
  ● Effect: Residents earning foreign income and paying foreign income taxes are taxed at a higher combined tax rate than the rate applied to domestic-source income
  ● Favourable for domestic investment

DOUBLE TAXATION RELIEF

○ EXEMPTION Method
  ● Taxation of residents on their domestic income and exemption of their foreign-source income
DOUBLE TAXATION RELIEF

EXEMPTION Method. Effects:
- Elimination of Residence – Source DT
- Exemption of all foreign-source income: Taxation on territorial basis
- Exemption of certain kinds of income (e.g. business income, investment income)

DOUBLE TAXATION RELIEF

EXEMPTION Method. Types:
- Ordinary Exemption
- Exemption with progression
- Full Exemption
- Partial Exemption
  - Participation exemption
DOUBLE TAXATION RELIEF

- EXEMPTION Method:
  - Ordinary Exemption
  - Exemption with progression
DOUBLE TAXATION RELIEF

○ EXEMPTION Method
  ● Partial exemption. Requirements of the method:
    ○ Source income and expenses rules
    ○ Anti-avoidance rules
    ○ Expense allocation rules

DOUBLE TAXATION RELIEF

○ EXEMPTION Method:
  ● Participation exemption

  Exemption of dividends derived from foreign companies in which the resident shareholder have a minimum ownership interest
DOUBLE TAXATION RELIEF

○ EXEMPTION Method’s Drawback

○ Shifting of tax burden from the income earner to the income payer in some circumstances

DOUBLE TAXATION RELIEF

○ CREDIT Method

● Foreign taxes paid by residents on foreign source income reduce the domestic taxes payable on the same income
DOUBLE TAXATION RELIEF

- CREDIT Method. Effects.
  - Eliminate residence – source double taxation
  - Usually limited to the amount of the domestic tax payable on the foreign source income (ordinary tax credit)

- Resident taxpayers are treated equally from the perspective of the total (domestic and foreign) tax burden, except if foreign tax > domestic tax
  - Neutral respect to place of investment (domestic – abroad)
DOUBLE TAXATION RELIEF

○ CREDIT Method. Limitations

- Overall (worldwide)
- Country-by-country
- Item-by-item

DOUBLE TAXATION RELIEF

○ CREDIT Method. Indirect (foreign) tax credit. Credit granted

- To a domestic corporation for the foreign income taxes paid by a foreign affiliated company
- When the domestic corporation receives the dividend distributed by its foreign affiliate
- Equal to the underlying foreign tax paid by the foreign affiliate on the income out of which the dividend was paid
DOUBLE TAXATION RELIEF

○ CREDIT Method. Indirect (foreign) tax credit.
  ● Possible effect: discouraging repatriate benefits. Solution?:
    ○ Taxation on accrual basis:
      ● CFC rules
      ● Offshore investment fund rules

DOUBLE TAXATION RELIEF

○ EXEMPTION vs CREDIT Methods
  ● Both authorized by OECD and UN MC
  ● Equal results if the foreign taxes paid by the foreign company (plus WHT) are at least equal to domestic taxes.
  ● Even if foreign taxes < domestic tax, deferment until dividends are paid
DOUBLE TAXATION RELIEF

- EXEMPTION vs CREDIT Methods
  - Both systems require rules:
    - Resident qualified taxpayers
    - Type of qualified income
    - Source of income
    - Allocation of expenses
    - CFC (current or accrual taxation)
    - Foreign losses
    - Computation of foreign Co income

DOUBLE TAXATION RELIEF

- EXEMPTION vs CREDIT Methods
  - Most important difference: requirement of different rules
    - Credit: definition of creditable foreign taxes
    - Exemption: determination when foreign source income is subject to a level of foreign tax comparable to domestic tax
TAX TREATIES

- Vienna Convention on the Law of Treaties. Art. 2:

  A treaty is an international agreement in one or more instruments, whatever called concluded between states and governed by international law.
TAX TREATIES

- Relation Treaties (International Law) – Domestic law
  - Monism
  - Dualism

TAX TREATIES - Objectives

- General:
  - Facilitate cross-border trade and investment eliminating tax impediments
TAX TREATIES - Objectives

○ Operational:
  - Elimination of double taxation
  - Prevention of tax evasion

○ Ancillary:
  - Elimination of discrimination
  - Exchange of information
  - Resolve disputes
TAX TREATIES - Models

- OECD
- UN
- USA

TAX TREATIES

- OECD MC
  - Draft 1963
  - Commentaries
  - Favours capital exporting countries
TAX TREATIES

- UN Model Treaty
  - First published 1980
  - Revised 2001
  - Commentary

TAX TREATIES

- OECD vs UN Model Treaty
  - UN Model follows the pattern of OECD MC
  - Main difference: UN Model imposes fewer restrictions to the source country
TAX TREATIES

  ● Reflects USA = Capital exporting country
    ○ All citizens are tax residents
    ○ Broad notion of business profits
    ○ LOB clause
    ○ Credit method

TAX TREATIES - Content

  ● Coverage, Scope and Legal Effect
  ● Business income
  ● Employment & Personal Services
  ● Immovable property income & CG
  ● WHT on investment income
  ● Other income
  ● Non-Discrimination, MAP, Exchange of information
TAX TREATIES - Interpretation

- Customary law
- Vienna Convention on the Law of Treaties (VCLT)

Art. 31(1) of the VCLT:

“A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose”.
TAX TREATIES

Art. 31(2) of the VCLT:

The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

a) any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;

b) any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

TAX TREATIES

Art. 31(3) of the VCLT:

There shall be taken into account, together with the context:

a) subsequent agreements between the parties regarding the interpretation of the treaty or the application of its provisions;

b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;

C) any relevant rules of international law applicable in the relations between the parties.
TAX TREATIES

- Art. 32 of the VCLT:

  "Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:
  a) leaves the meaning ambiguous or obscure; or
  b) leads to a result which is manifestly absurd or unreasonable"

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TAX TREATIES

- OECD MC. Interpretation
  - Commentaries
    - Reservations
    - Observations
TAX TREATIES

- Legal status of the OECD MC and its Commentaries:
  - Supplementary means of interpretation (Art. 32 VCLT)?
  - Context (Art. 31 VCLT)?

OECD & UN Models. Internal rule of interpretation: Art. 3(2):

“As regards the application of the Convention at any time by a CS, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.”
TAX TREATIES

- OECD & UN Models:
  - Internal rule of interpretation:
    - Art. 3(2)
      - Static approach
      - Ambulatory approach

Introduction to International Tax Law

TRANSFER PRICING
TRANSFER PRICING - Concept

○ TP: Price set by a taxpayer when selling to, buying from, or sharing resources with a related person
  - Inter company agreements
  - Individual – Company
  - Individual - Individual

TRANSFER PRICING

○ Related persons
  - 2 or more persons owned or controlled, directly or indirectly, by the same interests
TRANSFER PRICING

- Tax Authorities adjust TP to prevent shifting income to low tax jurisdictions
- Risk of double taxation

TRANSFER PRICING

- Arm's Length Principle (Method, Approach)
  - The establishment of TP in transactions between related parties should be based on the prices charged between unrelated parties in similar transactions
TRANSFER PRICING

○ Art. 9 OECD MC. Associated Enterprises:

a) An enterprise of a CS participates directly or indirectly in the management, control or capital of an enterprise of the other CS, or

b) The same persons participate directly or indirectly in the management, control or capital of an enterprise of a CS and an enterprise of the other CS

TRANSFER PRICING

○ Art. 9(1) OECD MC. Associated Enterprises:

Where in either case conditions are made or imposed between the 2 enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly
TRANSFER PRICING

- Risk of Double Taxation
  - Art. 9(2) and Art. 25 OECD MC:
    - Primary adjustment
    - Correlative adjustment
  - Advance Pricing Agreements (APA):
    - Unilateral
    - Bilateral
    - Multilateral

TRANSFER PRICING - Methods

- Methods to determine ALP
  - OECD TP Guidelines
  - US Regulations
TRANSFER PRICING

- Methods to determine ALP
  - Traditional methods
    - Comparable Uncontrolled Price (CUP)
    - Cost Plus
    - Resale Price
  - Additional methods
    - Transactional Net Margin (TNMM)
    - Profit-Split

- CUP Method
  - Preferred method. Product focus
  - ALP by reference to sales of similar products made between unrelated persons in similar circumstances
TRANSFER PRICING

- Resale Price Method
  - ALP by subtracting an appropriate mark-up from the price at which the goods are ultimately sold to unrelated parties

- Cost Plus Method
  - ALP by adding an appropriate amount of profit to the costs by multiplying the seller's costs by an appropriate profit percentage
TRANSFER PRICING

- **Transactional Net Margin Method (TNMM)**
  - AL Profits by applying the ratio of profits to some Profit Level Indicator of unrelated parties

TRANSFER PRICING

- **Profit-Split Method**
  - Applies to aggregate profits from a series of transactions
  - Computation of taxable income of related parties in same business/product line
  - Allocation amongst them in proportion to their contribution to the income
TRANSFER PRICING

- Cost Contribution Arrangements (CCA) (Cost Sharing Agreements)
  - Contractual arrangement under which prospective users of IP jointly develop and share in the costs of developing it and in ownership rights to that IP
ANTI-AVOIDANCE MEASURES

- Tax avoidance
- Tax evasion
- Tax fraud

ANTI-AVOIDANCE MEASURES

- Anti-avoidance rules & doctrines
- Tax haven provisions
- TP rules
- Thin capitalization rules
- Controlled Foreign Corporation rules (CFC rules)
- Offshore investment fund rules
- Exit taxes
- Anti-Treaty shopping. Limitation of Benefits (LOB)
ANTI-AVOIDANCE MEASURES

- Anti-avoidance rules & doctrines
  - Transactions may be disregarded for tax purposes
  - Statutory anti avoidance rules
  - Judicial anti avoidance doctrines

- Tax haven provisions
  - Black lists
  - White lists
  - General clause against “low tax jurisdictions”
ANTI-AVOIDANCE MEASURES

○ Transfer Pricing rules
  ● Documentation
  ● Advance Pricing Agreements (APAs)

ANTII-AVOIDANCE MEASURES

○ Thin Capitalization rules
  ● Prevent non resident shareholders of resident corporations from using excessive debt capital to extract corporate profits in the form of deductible interest rather than as non deductible dividends
ANTI-AVOIDANCE MEASURES

○ Thin Capitalization rules
  ● Non deductibility of interest paid by a resident corporation to a non-resident shareholder if the Company's equity is small in relation to its debt
ANTI-AVOIDANCE MEASURES

- Controlled Foreign Companies legislation (CFC rules)
  - Prevent the deferral of domestic taxation of foreign source income by establishing a foreign corporation or trust to receive the income
  - Attribution of the undistributed income to the shareholders

ANTI-AVOIDANCE MEASURES

- Controlled Foreign Companies legislation (CFC rules). Scope:
  - Non-resident entities
  - Taxed differently from their owners
  - Controlled by domestic shareholders or in which domestic shareholders have a substantial interest
ANTI-AVOIDANCE MEASURES

- Controlled Foreign Companies legislation (CFC rules). Scope:
  - Designated Jurisdiction approach
  - Global approach

- Entity approach
- Transactional approach ("tainted income"): Passive income – (Active) Business income
ANTI-AVOIDANCE MEASURES

- Offshore Investment Funds rules
  - Prevent the deferral of domestic tax through the use of offshore investment funds which are not subject to CFC rules

ANTI-AVOIDANCE MEASURES

- Offshore Investment Funds rules. Methods
  - Mark-to-market
  - Imputed income
  - Deemed distribution
  - Deferral charge
ANTI-AVOIDANCE MEASURES

- Exit Taxes
  - Taxation of gains on transfers of property abroad and on expatriation

- Anti treaty shopping rules (LOB clauses)
  - Denial of treaty benefits to a corporation resident in one CS which is a conduit for residents of a 3rd country
Art. 2 TEU:
- Union’s objectives (economic & social)
- Means to reach the objectives
  - Establishment of an internal market
  - Establishment of an economic & monetary union
EU TAX LAW

- Internal market requires = 4 fundamental freedoms = Free movement of:
  - Goods
  - Services
  - Persons
  - Capital

EU TAX LAW

- Fiscal obstacles to a common market
  - Fiscal burdens on the emigration of persons and on the internal border-crossing of goods, services, income or capital
  - Different tax treatment of domestic and imported goods and services
  - Disparities between national tax laws
  - Differential tax treatment of residents and non-residents
  - Differential tax treatment between domestic and foreign investment or income
EU TAX LAW

○ Measures to be taken for the establishment of the common market
  ● Positive integration
    ○ Tax harmonization
    ○ Tax coordination
  ● Negative integration
    ○ Repeal of discriminatory and restrictive features of national tax systems

EU TAX LAW

○ EU Customs Union
  ● TFEU provides that the Union shall be based upon a customs union (Art. 28):  
    ○ Prohibition of import and export duties or charge of equivalent effect (Art. 30)
    ○ Common customs tariff at the outside borders of the Community (Art. 31)
  ○ Community Customs Code
Harmonization of Indirect Taxes

- Prohibition of direct and indirect discrimination against foreign products and direct and indirect fiscal protection of domestic production (Art. 110)

- Harmonization of indirect taxes in so far as is necessary for the establishment and functioning of the internal market (Art. 113)

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Harmonization of Indirect Taxes


EU TAX LAW

- Harmonization of Direct taxes
  - Direct taxes not mentioned in the TFEU
  - Legal basis:
    - Art. 115: General harmonization provision
    - Art. 352: Complementary provision allowing “appropriate measures”

EU TAX LAW

- Art. 115 TFEU:
  “The Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the internal market.”
Art. 352 TFEU:

"If action by the Union should prove necessary, within the framework of the policies defined in the Treaties, to attain one of the objectives set out in the Treaties, and the Treaties have not provided the necessary powers, the Council, acting unanimously on a proposal from the Commission and after obtaining the consent of the European Parliament, shall adopt the appropriate measures (...)"

DIRECTIVES

- Parent-Subsidiary Directive
- Merger Directive
- Interest and Royalties Directive
- Savings directive
- Mutual Assistance Directive
- Recovery Assistance Directive
EU TAX LAW

- Parent-Subsidiary Directive
  - Elimination of WHT on outbound dividends distributed by a Sub to its Parent within the EU
  - Elimination of economic double taxation

EU TAX LAW

- Merger Directive
  - Deferral of tax claims due in the case of cross-border mergers, division, transfers of assets and exchanges of shares within the EU
EU TAX LAW

- Interest and Royalties Directive
  - No WHT on interest and royalty payments between associated companies

EU TAX LAW

- Savings Directive
  - Purpose: minimum level of taxation of interest received by individual taxpayers
  - MSs collect information from paying agents about interest payments to beneficial owners residing in other MSs
EU TAX LAW

- Mutual Assistance Directive
  - Mutual administrative assistance between the competent tax authorities and authorizes them to exchange information relevant for determining a taxpayer’s assessment

EU TAX LAW

- Recovery Assistance Directive
  - Mutual assistance to recover taxes on income and capital as well as taxes on insurance premiums
EU TAX LAW

- EU International Agreements
  - European Economic Area
  - Arbitration Convention

EU TAX LAW – ECJ Case Law

- Step by Step analysis by ECJ
  1. Is there a sufficient "nexus" for Community law to apply or is it a purely "internal situation"?
  2. If yes, is there a discriminatory restriction on a fundamental freedom
  3. If yes, is the restriction justified by imperative requirements in the general interest?
  4. If yes, is the measure suitable for attaining the objectives pursued? (test of suitability)
  5. If yes, does the measure in question not go beyond what is necessary in order to attain the objectives pursued? (Test of necessity)

(Steps 4 & 5 concern the Proportionality of the measure)
EU TAX LAW – ECJ Case Law

- Accepted Justifications
  - Coherence of the tax system
  - Territoriality
  - Balanced allocation of taxing powers
  - Prevention of tax avoidance and evasion
  - Prevention of double deduction of losses
  - Effectiveness of fiscal supervision

EU TAX LAW – ECJ Case Law

- Rejected Justifications
  - Absence of Harmonization
  - Administrative difficulties
  - Loss of tax revenue
  - Economic arguments
  - Counterbalancing advantages
THANK YOU!

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