TAX LAW

Academic Year 2016 / 2017

AGENDA - Session 4-

- Source of International Tax Law

a) Introduction

b) Worldwide vs Territoriality

c) The definition of tax residence

Required reading: OECD MC Article 4; OECD Commentary to Art.4 MC (All paragraphs)

Introduction on tax systems

General issues

- Direct Taxes are generally imposed on:

  – profits and capital of businesses;
  – income and net worth of individuals.

- Indirect taxes are levied on consumptions

Introduction on tax systems

General issues

- Subjective element:
  - Definition of taxpayer
- Objective element:
  - Determining taxable base
- Territoriality:
  - Defining tax jurisdiction

Introduction on tax systems

The taxpayer is the person liable for tax.

The term taxpayer does not necessarily identify a person who is obliged to pay tax in a particular tax period (indeed the taxpayer’s liability may be also satisfied by a person other than the taxpayer itself eg. withholding tax).

A taxpayer may also be required to fulfil certain administrative requirements, such as filing a tax return or provide information to the tax authorities.

Introduction on tax systems

The primary distinction for taxpayers is made between:

- individuals; and

- legal entities.

Residence & Source Jurisdiction

SOURCE JURISDICTION

- Income may be taxable under the tax laws of a country because of a link between that country and the activities which generated the income.

Residence & Source Jurisdiction

RESIDENCE JURISDICTION

- A country may also impose a tax because of a nexus between the country and the person earning the income. Person subject to the residence jurisdiction of a country generally are taxable on their worldwide income, without reference to the source of the income.

Defining residence

To exercise residence jurisdiction, a country must provide rules that classify individuals and legal entities either as residents or as non-residents.

Defining residence

Individuals

- Formal criteria (registration in the Registry of resident population; residence status for visa or immigration purposes; citizenship)
- Mechanical test (days of presence test):
  - 183 day test
  - Cumulative presence test considering a certain numbers of years.
- Fact and circumstances test
  - (..)
  - (…)

Defining residence

Factors which are usually considered relevant in determining the residence of an <u>individual</u>:

- maintenance of a dwelling or an abode that is available for the taxpayer’s use;
- place where the individual engages in income-producing activities;
- location of the individual’s family;
- social ties to the country.

Defining residence

The residence of a **corporation** is generally determined by reference to:

- Formal criteria
  - place of incorporation;
  - legal seat;
  - registration in the commercial register.

- Economic criteria:
  - place of management;
  - principal business location;
  - residence of the shareholders (rarely).

Defining residence

The <u>place of incorporation</u> test provides simplicity and certainty to the government and the taxpayer. Indeed, in general, a corporation cannot freely change its place of incorporation without triggering a tax on the accrued gains in respect of its properties.

The place of incorporation places some limits on the ability of corporations to shift their country of residence for tax avoidance purposes.

Defining residence

<u>The place of management</u> usually coincides with the place where the board of directors meets and exercise control over the affairs of the corporation (vs. day by day management).

The place of management test is less certain in its application. Such test is easily exploited for tax avoidance reasons because a change in the place of management generally can be accomplished without triggering any tax.

Defining residence

OECD MODEL CONVENTION – Article 4

Para. 1: main rule concerning resident persons

- Any person who is liable to world wide income taxation under the laws of the contracting state by reason of his domicile, residence, place of management or any other criterion of a similar nature.

Defining residence

OECD MODEL CONVENTION – Article 4

Para. 1: main rule concerning resident persons

- The residence concept is vital to determining the personal scope of the convention and for allocation of taxing rights to solve issues of double taxation in situations of residence and source conflicts or where dual residence arises. In order to provide further certainty as to the object and purpose of the term “resident”.

Defining residence

OECD MODEL CONVENTION – Article 4

“liable to tax”

- As a general rule, for the purposes of qualifying as a resident of a contracting state a persons connecting characteristics with that state must qualify that person liable for comprehensive taxation. Such a person who is said to qualify as liable for comprehensive taxation need not actually be subject to tax on part or all of his income for him to fall within the scope of para. 1 of Art. 4

Defining residence

OECD MODEL CONVENTION – Article 4

“citizenship” and the “place of incorporation”

- As an exception to the general tests applied by contracting states to levy comprehensive taxation on a person, there are certain states that apply merely formal criteria to levy such burdensome taxation. The criteria of citizenship and the place of incorporation have played a major role in the full or comprehensive taxation of persons in for example the United States and Canada.

Defining residence

OECD MODEL CONVENTION – Article 4

Partnerships

- In certain states, partnerships are disregarded for tax purposes and the taxation effectively takes place at the level of the partners. Where such states view the partnership as fiscally transparent, the partnership entity cannot be considered a resident of that state.

Defining residence

OECD MODEL CONVENTION – Article 4

Para. 2. Dual residence of individuals

- It may happen that two countries claim that an individual or a company is resident for tax purposes in both jurisdictions.

  In order to overcome such issue, most of the Tax Treaties provide a series of tie breaker rules to give residence jurisdiction to one country

Defining residence

OECD MODEL CONVENTION – Article 4

`centre of vital interests´

- This first rule set out in para. 2 allocates residence to the country in which the person’s permanent home is situated. The permanent home is explained as any place that the individual has arranged and retained for his permanent and continual use.

Defining residence

OECD MODEL CONVENTION – Article

´ habitual abode´

- The second rule laid down in para. 2 establishes a secondary criterion which resolves the issue of dual residence in the event a permanent home is available to the individual in both states or in neither of the states. In such circumstances, the test applied to tip the scale towards a particular contracting state is where the individual stays more frequently.

Defining residence

OECD MODEL CONVENTION – Article 4

´ nationality´

- As a final resort of allocating residence to one particular contracting state, use is made of the criterion of nationality in the event the above rules fail to resolve the dual residence issue. If this still fails to solve the problem then the competent authorities are assigned the duty of resolving the issue according to the Mutual Agreement Procedure.

Defining residence

OECD MODEL CONVENTION – Article 4

Para 3. dual residence of companies and other bodies of persons

- The resolving of a companies dual residence is tackled by way of one single rule, the place of the companies or body’s effective management.

Defining residence

OECD MODEL CONVENTION – Article 4

´ place of effective management´

- The criterion used is not one of a formal nature but rather a reference to actual management and business substance.
- The place where the key management and commercial decisions are made.