LIUC – Università Carlo Cattaneo

International Tax Law

a.a. 2019/2020

International Double Taxation and General Introduction to Tax Treaty Provisions

Prof. Marco Cerrato

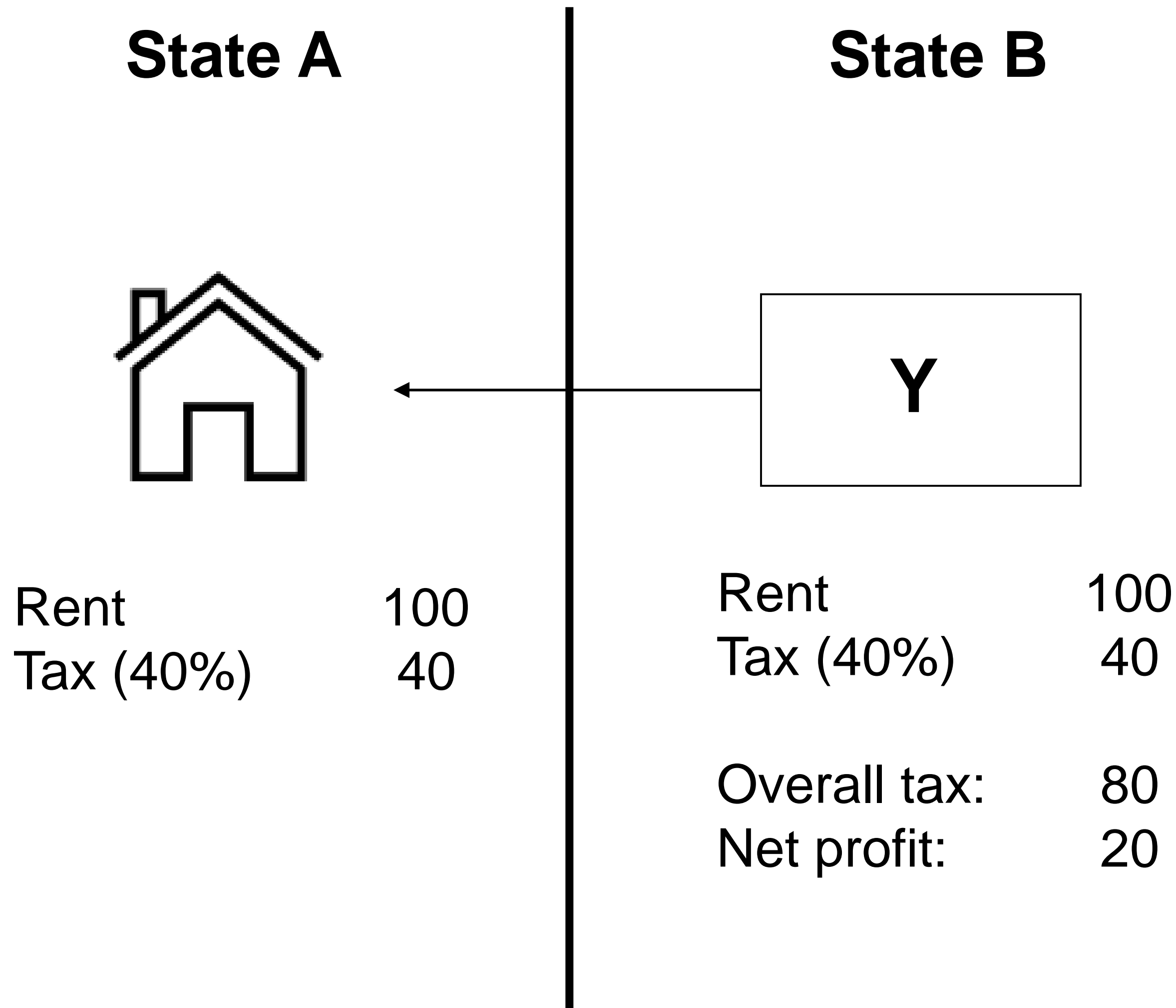
What is International Tax Law?

- International Tax Law deals with all those rules (both domestic and international) related to the taxation of cross-border activities and investments.

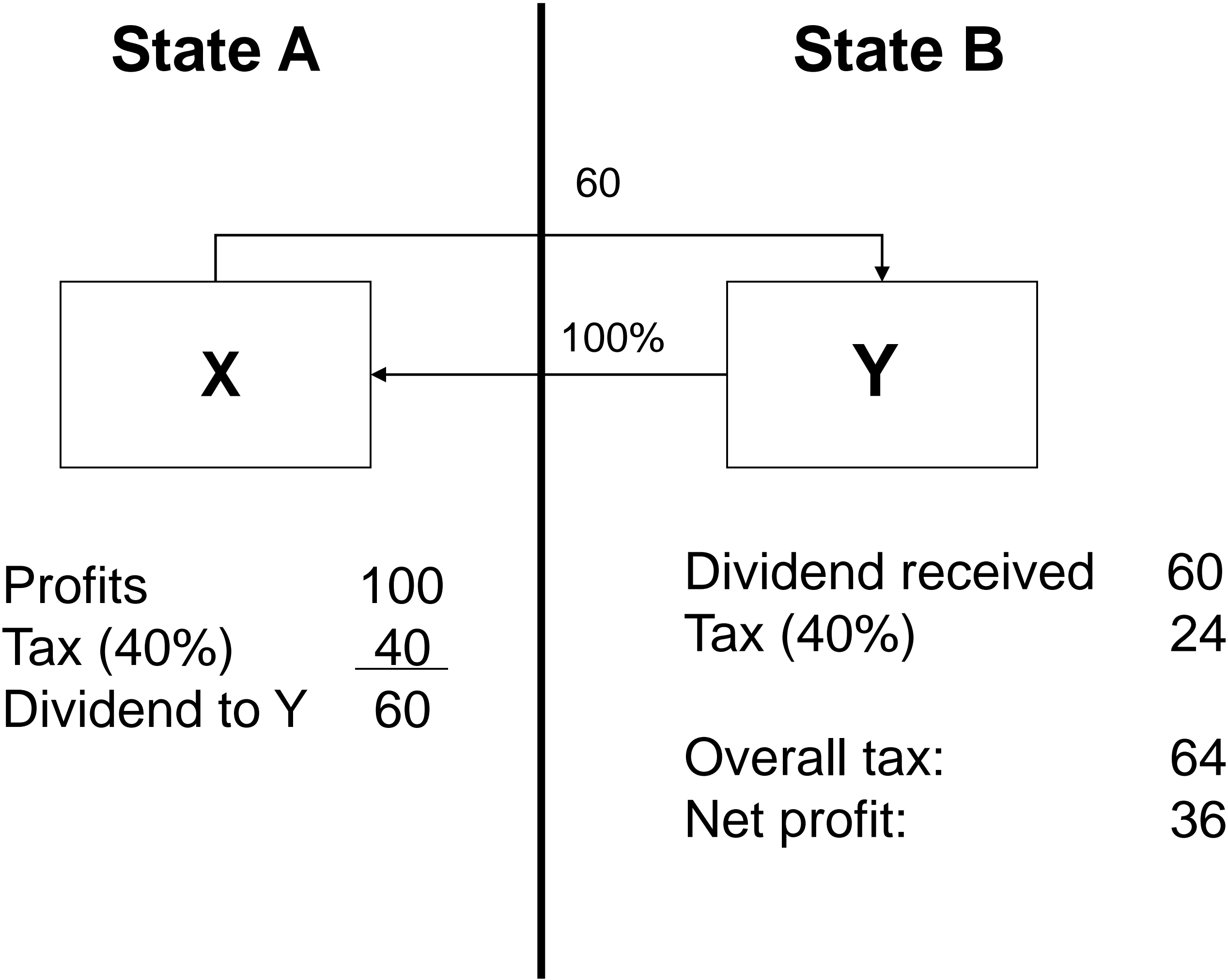
Definition of international double taxation

- Juridical double taxation: imposition of comparable taxes in two (or more) States on the same taxpayer in respect of the same subject matter and for identical periods (OECD Model Tax Convention, Introduction, paragraph 1).
- Economic double taxation: imposition of comparable taxes in two (or more) States on different taxpayers in respect of the same wealth.

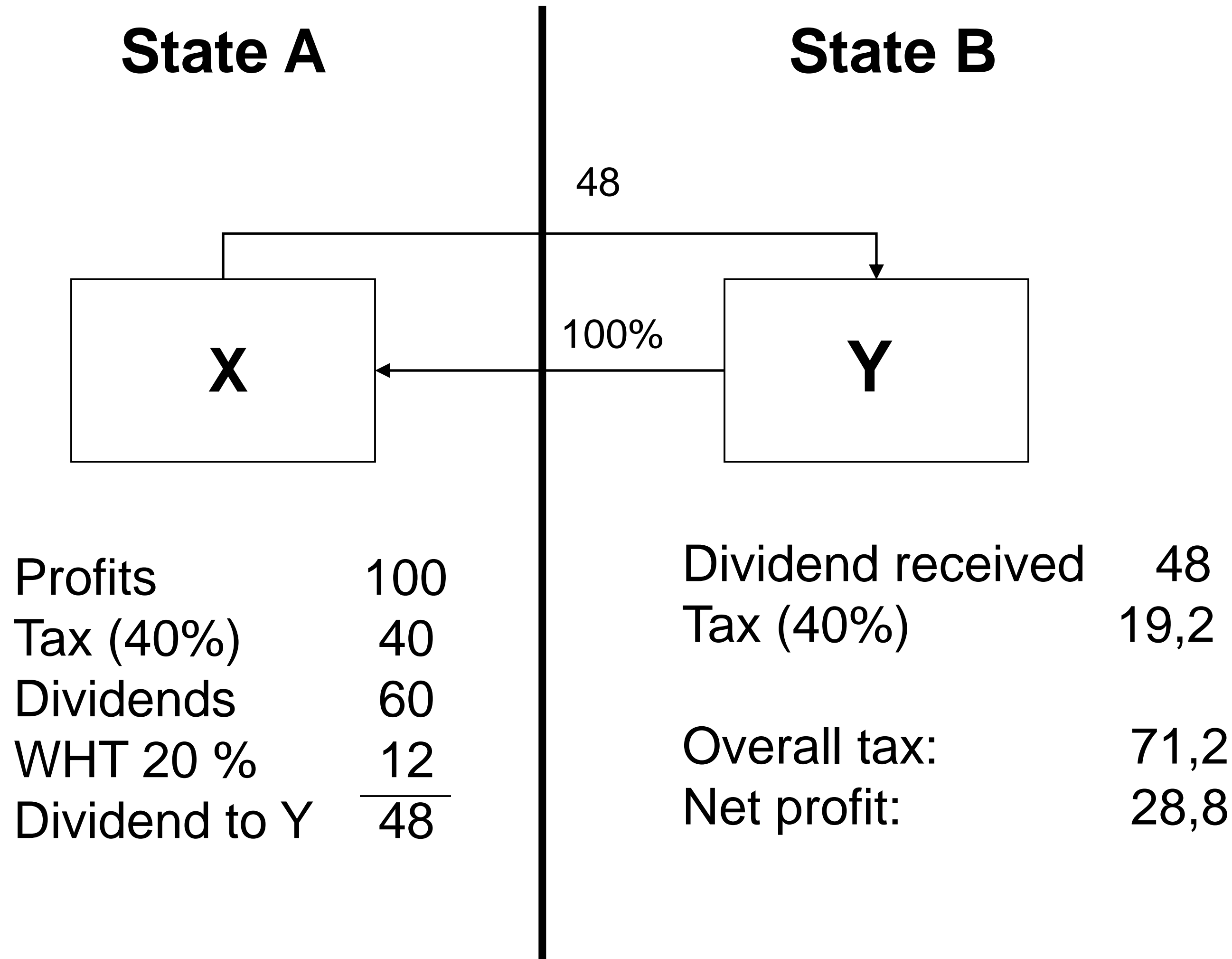
Example of juridical double taxation



Example of economic double taxation



Example of juridical and economic double taxation



Definition of international double taxation

- States are commonly more concerned about the detrimental effects of juridical double taxation, because it significantly affects international trades.
- States believe that international trades create wealth for the citizens and that juridical double taxation may discourage the positive effects of international trades.
- Double taxation relief is sometimes extended to economic double taxation.

Jurisdiction to Tax

- Income may be taxable under the laws of a country because of a nexus between that country and the income or the activities that generated the income: a jurisdictional claim based on such nexus is called «**source jurisdiction**».
- A country may also impose tax on income because of a nexus between the country and the person earning that income: such jurisdictional claim is called «**residence jurisdiction**».

Conflicts between personal and objective criteria of taxation

- World-wide taxation principle: residents are subject to tax on their income produced everywhere in the world (art. 3, paragraph 1, ITC).
- Principle of territorial taxation: non-residents are subject to tax only on the income produced within the Italian territory (artt. 23, 151 e 152, ITC).

Conflicts between personal and objective criteria of taxation

- Most countries tax their residents on their worldwide income and non-residents on their domestic source income.
- As a consequence, foreign source income earned by a resident of a country may be taxed by both the State in which the income is earned (**State of Source**) and the State in which the taxpayer is resident (**State of Residence**).
- International double taxation can arise from overlapping claims by two or more States to tax the same income.

Conflicts between personal and objective criteria of taxation

- Residence-source claims: one State asserts the right to tax foreign source income of a taxpayer because the taxpayer is a resident of that State, while another country asserts the right to tax the same income because the income arises or has its source in that State (most common scenario).

Conflicts between personal and objective criteria of taxation

- Source-source claims: two States assert the right to tax the same income of a taxpayer because they both claim that the income is sourced in their national territory.
- Residence-residence claims: two States assert the right to tax the same income of a taxpayer because they both claim that the taxpayer is a resident of their State. A taxpayer that is resident of two States is commonly referred to as a «dual-resident taxpayer».

Other conflicts able to determine double taxation

- Conflicts between residence and nationality (for example, USA and Philippines)
- Inheritance and gift tax (residence of the deceased – residence of the heirs – place of location of the estate)
- Value Added Tax (conflicts between principle of origin and principle of destination)

Double taxation and international law: problems

- Absence of a ban on double taxation: international double taxation is <u>not</u> prohibited by any international principle
- Right of non cooperation (*par in parem non habet imperium*)

Italian domestic double taxation rules

- Art. 163 ITC - Art. 67 Presidential Decree No. 600/1973 The same tax cannot be levied more than once in relation to the same taxable event. This applies also if the tax is levied on two different taxpayers.

Measures against international double taxation

- Domestic unilateral measures
- Bilateral or multilateral measures (e.g. **tax treaties**)
- EU Directives

The role of tax treaties

- Allocation of tax between the treaty parties
- Resolve problems and create benefits that cannot be achieved unilaterally
- Create an environment of fiscal certainty which encourages trade and investments between countries
- Instrument for tax authorities to co-operate and exchange information on taxpayers

International tax avoidance and evasion

- International business operations are may also present opportunities for tax avoidance and tax evasion.
- These concepts involve a reduction or elimination of tax liability through either legitimate/legal means (tax avoidance) or through illegitimate/illegal means (tax evasion).

OECD Model Tax Convention

- It has long been recognised among the member countries of the Organisation for Economic Co-operation and Development (**OECD**) that it is desirable to clarify, standardise, and confirm the fiscal situation of taxpayers who are engaged in commercial, industrial, financial, or any other activities in other countries through the application by all countries of common solutions to identical cases of double taxation.
- This is the main purpose of the *OECD Model Tax Convention on Income and on Capital*, which provides a mean of settling on a uniform basis the most common problems that arise in the field of international juridical double taxation.

OECD Model Tax Convention

- The OECD Model Convention is used by Member States as a basis for negotiations of tax treaties.
- The first draft of the Model Tax Convention was published in 1963.
- The first official version of the Model Tax Convention was published in 1977 and then revised in 1992.
- From 1992 the OECD updated the Model Tax Convention 10 times (in 1994, 1995, 1997, 2000, 2002, 2005, 2008, 2010, 2014 and 2017).

OECD Member States

Austria, Belgium, Canada, Denmark, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States (members since the set up of the OECD), Japan, Finland, Australia, New Zealand, Mexico, Czech Republic, Hungary, Poland, Korea, Slovak Republic, Israel, Estonia, Chile, Slovenia Latvia, Lithuania (States that were admitted later on)

Structure of the Model Convention

- In addition to the text of the Model Convention (30 articles), a Commentary, article to article, is attached to the Model, as well as the position of some States that are not members of the OECD (Albania, Argentina, Armenia, Azerbaijan, Belarus, Brazil, Bulgaria, China, Colombia, Costa Rica, Croatia, Democratic Republic of the Congo, Gabon, Georgia, Hong Kong, India, Indonesia, Ivory Coast, Kazakhstan, Malaysia, Morocco, Philippines, Romania, Russia, Serbia, Singapore, South Africa, Thailand, Tunisia, Ukraine, United Arab Emirates, Vietnam)
- The Commentary includes the observations and reservations made by member States on each article

Structure of the OECD Model Convention

- Chap. I: Scope of the Convention (Artt. 1-2).
- Chap. II: Definitions (Artt. 3-5)
- Chap. III: Taxation of Income (Artt. 6-21)
- Chap. IV: Taxation of Capital (Art 22)
- Chap. V: Methods for elimination of double taxation (Art. 23 A e B)
- Chap. VI: Special Provisions (Artt. 24-30)
- Chap. VII: Final Provisions (Artt. 31-32)

Model Convention and taxation of income (Artt. 6-21)

- Unlimited right to tax of the State of Source: income from immovable property, permanent establishment, entertainers and sportspersons, income from employment
- Limited right to tax of the SS: dividends, interest, (royalties)
- No right to tax of the State of Source: capital gains, business profits without a PE, (royalties)

Model Convention and Special Provisions (Artt. 24-29)

- Non-discrimination
- Mutual agreement procedure
- Exchange of information
- Members of diplomatic missions and consular posts
- Territorial extension

Elimination of international juridical double taxation

- **Exemption method**
  - Full exemption
  - Exemption with progression (Art. 23 A)
- **Credit method**
  - Full tax credit
  - Ordinary tax credit (Art. 23 B)
- **Deduction method**

Typologies of ordinary tax credit

- Overall tax credit (*e.g*. Italy)

- Per country limitation (*e.g*. Italy)

- Per income category limitation (*e.g*., USA)

Other Model Tax Conventions

- Developing Countries tend to use the UN Model Convention.
- Tax authorities of some jurisdictions designed models that are different than the OECD Model in order to take into account the peculiarities of their tax systems.
- The USA and the States of Latin America developed their own Model Tax Convention

Emerging issues

- Base Erosion and Profit Shifting (BEPS)
- Tax challenges posed by the digital economy
- Multilateral Convention to implement tax treaty related measures to prevent base erosion and profit shifting (MLI)