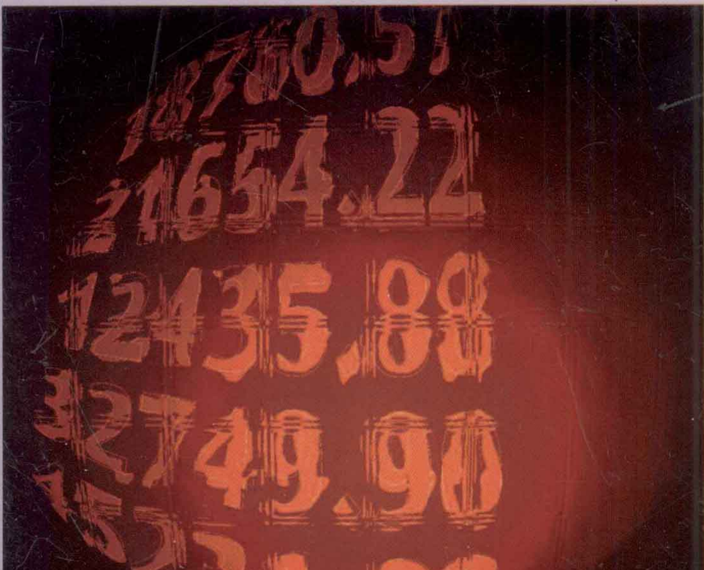
Principles of International Taxation



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Principles of International Taxation

by

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Preface

We have both been teaching International Taxation for more years than we care to remember, but have never found a book to recommend as reading to students who are fairly new to international taxation, indeed many of whom are new to taxation in any guise. The lack of a suitable textbook can create a false impression of the level of difficulty of the topic.

With a shared commitment to providing students with sound basic information, and guidance as to how best to further their knowledge of the subject, we embarked on this project with the aim of producing a text that will underpin an introductory course in International Taxation. We hope that the book will also prove useful to practitioners and policy makers who want to get back to basics and examine what lies beneath the current complexities of international tax rules and regulations, or perhaps to acquire a broader understanding of the principles. It is not our intention to produce a comprehensive reference guide to the regulatory environment, since others have done this already, but rather to provide a solid foundation in the principles and policies of international taxation in generic terms, as well as an introduction to some UK specific rules. In addition, we have tried to provide a blend of theory, policy and practical application for each of the topics under discussion.

This book examines international tax principles primarily from the viewpoint of a multinational group of companies. However, where appropriate, the concerns of the tax authorities are addressed and wherever possible we have advanced the reasoning behind the various anti-avoidance measures affecting international groups. The international taxation of high net worth individuals and trusts is not covered in this book, although we devote two chapters to the taxation of expatriate staff.

The book is in five sections. The first section is a brief introduction to taxation generally including the different forms that taxation may take and how tax systems are designed and administered, which can be skipped by those with some basic level of understanding. The second section is designed to introduce some key issues in international taxation, globalisation, residence, source, double taxation and an introduction to double tax treaties In the third section we consider what happens when one moves from doing business with another country to doing business in another country, and begin to examine key features of the operation of double tax treaties. The fourth section expands on the third by examining the way in which differences in tax systems can be exploited by taxpayers to minimise global tax liabilities, and the measures adopted by governments to combat perceived tax avoidance. In the final section we examine some broad policy issues touching on some important current debates in the international tax arena.

Angharad Miller & Lynne Oats
July 2006

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Decisions of the European Court of Justice are listed numerically after the main table.

Glossary

Administrative costs	public sector or government costs incurred in administering the tax legislation and regulations.
Alternative Minimum Tax	a special base level tax, usually computed as a percentage of gross income, imposed to combat tax minimisation by high income earners. Used in the US.
Anti avoidance measures	measures to combat the avoidance of tax are found in taxation legislation as well as double tax treaties. They may be targeted at specific activities or in some cases a generic rule is used that disregards transactions entered into for tax avoidance purposes.
Arm's length principle	this term refers to unrelated parties dealing with each other wholly independently. Where parties to an agreement are related in some way, it may be that the price is not that which would apply if they were not so related. Tax legislation and double tax treaties often give the government power to substitute an arm's length price for tax purposes, for the actual price used between related parties.
Average tax rate	is derived by dividing taxable income by tax payable. This is sometimes referred to as the effective tax rate.
Beneficial owner	in common law countries the term is used to mean the persons who ultimately enjoy the benefit of an asset. Beneficial and legal ownership may be with different parties, for example in trust or agency relationships.
Branch profits tax	many countries subject the profits of branches of foreign companies to an additional tax, so that they are treated in the same way as subsidiaries which generally pay withholding tax on profits distributed as dividends.
Broad based consumption tax	a generic term to describe consumption tax that applies to a broad range of goods and services, as distinct from narrow based which target specific items.
Capital export Neutrality	this is where investors in the capital exporting country are subject to the same effective tax rate on income from domestic investment and income from foreign investment, that is the decision whether to invest at home or abroad is tax neutral.

Capital import Neutrality	this is a term used by economists to describe the position where domestic and foreign investors receive the same after tax rate of return on similar investments in that market.
Capital gains (losses)	arise (are realised) on the disposal of assets and are the change in value of the asset between purchase and sale
Civil law	body of law based primarily on statutes rather than judicial decisions.
Classical system	the classical system of company tax involves taxation of companies as separate entities and no allowance given to shareholders in receipt of dividend income for company tax paid.
Common law	legal system based on the common law of England, although different jurisdictions have developed differently, so it can't be assumed that all common law countries have the same approach to the law.
Company tax	or corporation tax is a tax on company income. Its tax base is corporate profits, which are generally different from the profits reported for other purposes such as under financial reporting rules.
Competent Authority	under double tax agreements, both countries appoint a representative such as the Ministry of Finance to try to resolve disputes that arise from the operation of the treaty.
Compliance Costs	costs incurred by taxpayers or third parties in meeting the requirements laid on them by the tax rules and regulations.
Controlled foreign Company (CFC)	this term is used in the context of legislation aimed at preventing tax deferral by using companies in low tax jurisdictions, where the company involved is controlled by the country with the CFC legislation.
Consumption tax	a tax levied on the purchase of goods and services. Value added tax, goods and services tax, retail sales tax, and manufacture sales tax are examples of consumption taxes.
Customs duties	taxes on goods imported into a country.
Death duties	taxes imposed on property transferred on the death of the owner. Also referred to as inheritance taxes, estate duty, succession tax.
Depreciation	the allowable portion of the cost of the depreciable assets that are used up during an income generating activity that can be included in the cost of production.

Direct taxes	are taxes which cannot be shifted from the legal taxpayer to the ultimate consumer of the good or service. Personal and company income taxes, payroll taxes and property taxes are usually considered to be direct taxes.
Dividends	distribution of profits by a company to its shareholders.
Domicile	a person's domicile is his or her permanent home, the place to which he or she always intends to return.
Double taxation	arises when the same activity is taxed more than once as in the case of taxation of distribution of corporate profits under a classical system of company tax.
Effective rate of tax	Actual tax payable on the profits before taxation as shown in the financial accounts
Energy tax	taxes on fossil fuels with a view to reducing emissions of carbon dioxide and other greenhouse gases.
Evasion	this is the illegal or fraudulent arrangement of affairs to eliminate or reduce tax liability.
Excise tax	a tax on the production of a particular good or services. It may be either a fixed rate (for example dollars per kilo) or ad valorem (varying according to the value for example x% per dollar). Cigarettes, alcohol and petrol are among the goods most commonly subjected to an excise tax or duty.
Exemptions	tax rules will often provide exemptions for particular people, items or transactions which would otherwise be taxed.
Force of attraction	under this "rule" permanent establishments are taxed not only on income and property directly attributable to them, but also on all other income earned from sources in the country where the permanent establishment is located.
Foreign tax credit	a system for the relief of double taxation so that foreign sourced income of residents is taxed in the home country but then credit is allowed for foreign tax paid on that income.
Gift duty	a gift is a gratuitous transfer of property during the donor's life. Many countries levy a gift tax on such transfers by reference to the value of the gift.
Immovable property	this term generally covers land and buildings.

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Incidence of tax	the legal incidence is the point where tax is legally assessed. The effective or economic incidence refers to the ultimate bearer of the tax.
Income	this is a difficult concept to define, but it can generally encompasses employment income, business profits, rental income, interest.
Income taxes	income tax is a direct tax, usually imposed annually on the income of individuals and other entities such as companies.
Indirect taxes	taxes which can be shifted from the legal taxpayer to the economic taxpayer. Consumption taxes are usually deliberately designed to be indirect taxes.
Integration	in connection with company and personal income taxes refers to the process of taxing all company income at the individual's level using personal income tax rates.
Intellectual property	Literary, dramatic, musical and scientific works are intellectual property which is protected by copyright, patent, registered design, or trademark. Payments for the use of intellectual property are referred to as royalties.
Know-How	technical information necessary to reproduce a product or process.
Land Tax	a tax assessed on the value of land, usually the annual rental value and may be with or without buildings.
Letter box company	a company which has complied only with the bare essentials for registration in a particular country, it really only exists on paper and doesn't actually conduct any activities.
Limitation on benefits	a tax treaty provision with the aim of preventing treaty shopping, which limits treaty benefits, for example reduced rates of withholding tax, to those who meet specified criteria.
Manufacturer's sales tax	is a single stage sales tax that is collected at the manufacturing level of the production/distribution process
Marginal tax rate	is the rate applicable to the last unit of the tax base.
Multinational enterprise	company or group of companies with business establishments in two or more countries.
Neutrality	a principle which states that taxes should not affect the economic decisions of consumers or producers.

OECD	the Organisation for Economic Co-operative and Development is an organisation composed of representatives of the industrialised countries in Europe, the U.S., Japan, Canada, Australia and New Zealand. It was founded in 1961 and provides economic research and statistics and offers a forum for discussing and co-ordinating policies of common interest.
Partnership	an association of two or more persons. In some countries partnerships are treated as separate entities for tax purposes, in others they are not.
Payroll tax	a tax on the payroll or sums paid to employees.
Permanent establishment	this term is used in double tax agreements to determine whether a non resident has sufficient presence in a country to justify being taxed on the business profits it earns there.
Personal taxes	include all taxes paid by individuals, income, payroll, consumption and wealth taxes.
Poll tax	a per capita tax, or a tax per head of population, normally a fixed amount and not in common use.
Portfolio investment	a holding of shares in a company which is a small proportion of the total shares, usually less than 10%.
Profit shifting	the allocation of income and expenses between related organisations to reduce overall world wide tax liability.
Progressive tax	a tax by which the ratio of tax paid to income is higher for high income individuals than for low income ones. A progressive tax rate has a marginal rate which is always in excess of the average rate of tax.
Property tax	tax imposed on property ownership.
Regressive tax	is one by which the ratio of tax paid to income is lower for high income earners than for low income earners. The average rate of tax falls as income rises. Consumption taxes are often viewed as regressive as consumption is a larger share of income for the poor.
Residence	this is a common basis for the imposition of taxes, sometimes, but not always, defined in tax legislation.
Royalties	payments for the use of, or the right to use, intellectual property.
Schedular tax system	where income from different sources is taxed separately for example business profits, employment income, property income.

Taxable Income	the amount on which income tax is levied, usually defined by statute.
Tax base	the object to which the tax applies, for example, income, consumption or wealth.
Tax expenditures	is revenue foregone by a government as a result of special provisions of the tax legislation which, for example, grant preferential tax rates or exclude certain things from the tax base.
Tax havens	countries with very low or even nil tax rates on some or all forms of income.
Tax incentives	special provisions promote a particular activity such as investment in particular activities or geographical regions.
Tax incidence	is the ultimate distribution of the tax burden. The initial payer of the tax may be able to shift the burden of the tax to others (see direct and indirect taxes).
Tax shelter	is a provision of the tax legislation which allows individuals to reduce or eliminate tax liabilities, a form of tax expenditure.
Tax sparing	a special category of double tax relief in tax treaties to prevent tax incentives from being overridden by the treaty partner.
Tax treaty	is a treaty between nations concerning the tax treatment of income of each country's citizens and corporations which is generated in the other country.
Value added tax	VAT is levied on goods and services based on their increase in value as they move through the cycle from production to consumption. It is a form of multi-stage consumption tax.
Wealth taxes	are taxes based on the ownership of wealth and include taxes on real property, estate taxes and annual wealth taxes.
Withholding tax	a tax payable at the source where it is a final tax i.e. a third party is charged with the task of deducting tax from certain payments and remitting it to the government.

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