



# International tax policy

**Tashkent state university of economics**

*Lecture 10*



# Tax treaties

- ◎ Concluded between contracting states in order to eliminate double taxation and prevent tax avoidance
- ◎ Only binding between the signing states (usually two states = bilateral, Nordic Tax Treaty = multilateral)
- ◎ OECD Model Convention as basis for common understanding
- ◎ OECD Model Commentaries
- ◎ OECD Transfer Pricing Guidelines

# Tax treaties

## ◎ Scope

- Applied to persons who are residents of one or both of the Contracting States
- Finnish tax treaties usually cover income taxes imposed on behalf of the contracting state or its political subdivision

# Tax treaties

## ◎ Purpose

- Allocation of taxing rights (residence state or source state or both)
  - Allocation depends on the income type (i.e. business income, dividend, royalty, interest etc.)
- Avoidance of double taxation (credit method, exemption method)
- Prevention of tax avoidance (anti-abuse rules, information exchange rules)

## Structure of a tax treaty - OECD Model Convention

- Scope of the convention (Art. 1, 2)
- Definitions (Art. 3 – 5)
- Allocation rules: income (Art. 6 – 19)
  - from certain activities
  - from certain assets
  - capital gains
  - students (Art. 20)
  - catch-all clause (Art. 21)
- Allocation rule: capital (Art. 22)
- Elimination of double taxation (Art. 23)
- Special provisions (Art. 24 – 28)
- Final provisions (Art. 29, 30)
- Frequently: Protocol

## Main allocation rules regarding income from business activities

### ◎ Business profits (OECD MC Art. 7, 9)

- Taxation in the residence state
- Taxation also in the source state provided that a PE is established therein
- Profits should be determined in accordance with the arm's length principle

### ◎ Dividends (Art. 10)

- Taxation in the residence state
- Taxation also in the source state but limited to 5-15%

## Main allocation rules regarding income from business activities

### ⊙ Interest (Art. 11)

- Taxation in the residence state
- Taxation also in the source state but limited to 5-10%

### ⊙ Royalties (Art. 12)

- Taxation in the residence state

### ⊙ Capital gains (Art. 6,13)

- Taxation in the residence state
- Taxation also in the source state if gains on immovable property (e.g. real estate)

## Main methods for elimination of juridical double taxation

### ⊙ Exemption method (Art. 23A)

- Income taxed in the source state is exempted from tax in the residence state

### ⊙ Credit method (Art. 23B)

- Deduction for the tax paid in the source state against the tax payable in the residence state on the same income

# Finnish income tax treaties

- ◎ Treaties with more than 70 states incl. all EU member states
- ◎ Based on the OECD Model Convention (with developing countries may hold elements from the UN Model)
- ◎ Usually credit method. Exemption method only in a few treaties (e.g. with France, Portugal and Spain)
- ◎ Typical limitations to Finland's taxing right as a source state
  - Business income: no limit if a PE
  - Dividends 15%
  - Dividends from qualifying companies 0%. Threshold: ownership  $\geq 5\%$  of the Finnish company's capital
  - Interest and royalty 0%

# treaties and domestic law

- ◎ According to international law, a tax treaty always overrides domestic tax law
  - Tax treaties do, however, not impose taxes
- ◎ Taxing rights are based on domestic tax law
  - Tax treaties may only limit the contracting states' taxing rights (so called “golden rule”)
  - E.g. According to TVL 9.2 § interest income paid to a non-resident recipient is exempt from tax in Finland
    - Even if a tax treaty would allow source state taxation, Finland may not tax the interest

## Anti-abuse rules

- ◎ Anti-abuse rules deny tax treaty benefits to person that would otherwise qualify as a resident
- ◎ Purpose is to limit tax treaty benefits to bona-fide residents
  - Prevent so called “treaty shopping” i.e. non-residents organizing intermediary entities in tax treaty countries merely to obtain treaty benefits
- ◎ Finnish tax treaties include some types of anti-abuse rules but in practice they are rarely applied by Finland



## EU tax law

### ◎ Positive integration

- Harmonization of national tax rules by way of directives
  - ◎ Parent-Subsidiary Directive
  - ◎ Merger Directive
  - ◎ Interest-Royalty Directive



## EU tax law

### ◎ Positive integration

- Enhancement of co-operation among tax authorities by way of directives
  - ◎ Mutual Assistance Directive
  - ◎ Recovery Assistance Directive
  - ◎ Savings Directive

## ◎ Directives

- “A directive shall be binding, as to the result to be achieved, upon each member state to which it is addressed, but shall leave to the national authorities the choice of form and methods”
- Must be implemented by the EU member states into their national tax laws
- Adoption of directives in the field of direct taxation require unanimity
- Actors: EU Commission, Parliament & Council