

Conventions to Avoid Double Taxation, Deficient Aspects

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Abstract

This paper aims to empirically analyze the transnational double taxation issue, starting from the legal framework and showing through examples and situations, the manifestations of the double taxation phenomenon. The importance of the study is of extreme importance in the current economic context, since the main concern of E.U. is to mitigate the risks of Base erosion and profit shifting (BEPS). OECD defines BEPS strategies as "exploiting gaps and mismatches in tax rules", so concerns and studies in this field are of utmost importance.

The integration of Romania into the European Union meant for the majority of taxpayers a means of perfecting their means of production as well as of their technologies, but also of increasing their economic and financial cooperation with different states.

As a result, many natural and legal persons carry out activities from which they obtain income from two or more states. Therefore, they can be in economic connection with these states that put them in unfavourable situations, because, each state having its own tax system, the taxpayer can be subjected to a double taxation having the same tax base.

Key words: double taxation, taxes, tax competition

J.E.L. classification: H26, H21

1. Introduction

The phenomenon of double taxation appears, which is characterized by subjecting the same tax base to two or more taxes, for an identical period of time. Double taxation is neither beneficial to the state nor to the taxpayer, and its elimination is necessary in order to develop economic relations and to increase the international exchanges of goods.

When two states decide to sign a double taxation convention must respect the general framework of the two baseline models which are recommended and agreed by Organization for Economic Cooperation and Development and the United Nations are considered.

The taxation of the same taxable item in two or more states within the same time frame means double international taxation.

In the conventions for avoiding double taxation, the taxes to which the convention applies are specified. In all cases, income taxes are envisaged.

2. Theoretical background

Each state, by exercising their sovereign right to impose taxes and fees, has regulated the issue of taxation not only for the citizens of the respective state, but also for non-resident individuals who obtain incomes on the territory of the respective state. All the states in this world are defining the taxes, are setting the payment terms, are establishing the tax system and are granting sanctions. The taxation can be a double taxation for non-residents: first in the state where the incomes are obtained, not being the state of residence, and the second time in the state of residence. Thus, double taxation appears, which is neither beneficial to the state of residence nor to the source state.

If this problem would not be regulated, the states would be in a permanent conflict regarding the taxes levied on the incomes obtained.

As explained by Spitz (Spitz, 1972, p.24) in the paper "*International tax planning*", double taxation is "*a problem that generates the increase of fiscal pressure and the emergence of tax evasion*", and "*occurs when the authorities of two or more states simultaneously collect taxes with the same incidence, in such a way that a person bears a heavier tax obligation than if they were subjected to a single fiscal authority*", but in a more complete definition, double taxation means "*to subject to taxation the same taxable matter and for the same period of time by 2 tax entities from different countries*" (Moșteanu, 2003, p.8). Professor George N. Leon (Leon, 1925, p.310-329) in his paper "*Items of finance sciences*" makes a complex analysis, especially for his period, of the notion of double taxation „*established by the same fiscal authority*”, „*exercised by different financial authorities*”. As a result, double taxation occurs when two tax authorities in two states at the same time collect taxes with the same tax base.

Double taxation appears only on direct taxes (income tax and wealth tax) and cannot appear on indirect taxes. This rule applies on double taxation because the citizens of one state, when they are on the territory of another state, as buyers, the same taxes are included in the prices of goods bought as citizens of the respective state.

3. Forms of manifestation of double taxation

Double economic or internal taxation and double international taxation are the two forms defined in fiscal theory and practice as double taxation.

Double economic taxation is manifested by subjecting to multiple taxes from one and the same income within the same state. When are met the conditions of different taxable subjects (different beneficiaries of income), taxed for the same taxable item (tax base) and taxed within the same country means that this is the most eloquent example of a taxation of the corporate income, as a distinct taxpayer, and the subsequent taxation of the income distributed to shareholders (taxation of dividends). This occurs when the following conditions are met (Bișa, p. 323).

Double international taxation represents the taxation of the same taxable matter two times in different states in identical periods of time. This occurs when the following conditions are met (Bișa, 2005, p. 323):

- „*Taxation of the same taxable matter (taxable item)*”;
- „*Taxation of the same tax base (income or capital)*”;
- „*The application of two or more taxes - which are similar*”;
- „*Taxation in different states*”;
- „*Taxation in the same time frame*”.

The condition of taxation of the same taxable matter (taxable item), the condition of the same tax base (income or capital), the condition of application of two or more taxes - which are similar, the condition of taxation in different states and the condition of taxation in the same time frame are met when the taxation was made for the same taxable matter two times in different *countries*” (Văcărel, 2001, p.437).states in identical periods of time.

The phenomenon of double international taxation has also been defined as a taxation on comparable taxes in two or more states of the income or assets of the same taxpayer, for a limited period of time.

The definition of the international double taxation is that the international double taxation is the collection of comparable taxes in two (or more) states from the same taxpayer for the same activity and for identical periods. The definition was made by OECD Model Tax Convention.

The natural or legal person which is obliged by law to pay taxes is defined as a taxpayer in Law no. 227/2015 regarding the Fiscal Code with the Methodological Norms of Application.

Deliberate and accidental double taxation (Mosteanu, 2003, p.13) can be the forms of double international taxation.

The deliberate double international taxation can be regarded as a taxation intended by the legislator, which tries to hinder the competition of the foreign capital in an economic branch, while the double accidental taxation meets at the coincidence of the different taxes from different states or from the same country.

Collecting the incomes obtained in the respective state by the local and foreign taxable subjects and, on the other hand, they subject to taxation the incomes obtained abroad by natural and legal persons leads to double taxation which is established by the governments of the different states.

4. Causes of the phenomenon of double taxation

As a result of the development of the means of production and of technologies, of the enlargement of the market, of the exchanges of goods beyond the borders of the state, situations arise in which the same individual is in economic connection with two or more states.

A human being can live in one state, earn income in another state and be the citizen in a third state. Therefore, a negative effect of the double international taxation on taxpayer is the taxation on the obtained income first, in the state of origin of the income and, secondly and in double extent, in the state where he has his residence. The phenomenon of double taxation can be determined by a number of causes (Moşteanu, 2003, p.11.):

- „The governments of some states apply taxes on the incomes realized in the respective territories by the local taxable subjects (their own citizens) and foreigners, and on the other hand they subject to taxation the incomes realized abroad by their own citizens”;
- „The different interpretations of the terms of resident, source of income, domicile, etc. Due to the different content (from one country to another) of these concepts, it is possible that the same taxable subject may be considered a resident in two or more states”;
- „The particularities of fiscal policy and of tax systems in one country or another. These can lead to the occurrence of double taxation and the cessation of income producing activities”.

In the Communication of the Committee to the European Parliament, the Council and the European Economic and Social Committee, Brussels, 11.11.2011 regarding the "Double Taxation on the Single Market", the notion of double taxation may "appear as a consequence of a double residence or of taxation, both the state of residence, as well as in the source state". In this situation, the Committee, illustrates two examples to explain in more detail the double residence:

Example 1. „As regards double tax residence, double taxation may be caused by the application of divergent criteria. For example, a company may be considered as a resident for fiscal purposes in the Member State in which it is legally registered and, simultaneously, in another Member State where its main activity is carried on. In this situation, the company may be obliged to pay corporate tax for the income obtained worldwide in both Member States, thus paying twice the same income tax”.

Example 2. „Member States generally tax non-resident taxpayers for the income obtained from sources located on their territory. This taxation at source may superimpose over the taxation of global income in the taxpayer's state of residence. For example, an artist resident in a Member State signs a global contract to perform concerts in several Member States, which authorizes the broadcasting of concerts and the making of a live album of the tour. The revenues obtained from the respective contract could be taxed two or more times (in the state of residence and in the states where the concerts are held), as well as the copyright received by the artist”.

In this communication is also stated: „Double taxation increases the global tax burden, thus having a negative effect on capital investments”.

The research conducted show that taxation accounts for a non-negligible impact on the decisions regarding foreign direct investments (Hajkova et al., 2006).

5. The need to avoid double taxation and the consequences of double taxation

It is necessary to introduce taxation rules, so that companies can adapt to the demands of the market, to develop their productivity and to consolidate their competitive position in order to ensure the functioning and the realization of internal markets. The double taxation strategies may also influence state owned companies and the mechanisms of performance measurement (Munteanu, 2018) when perceived as collected on economic grounds in correspondence with

foreign investments. If the fiscal framework has loopholes and sometimes leaves room for different interpretations regarding the rules applied or in cases of double taxation, companies but also citizens can solve those loopholes, eliminate barriers, so that the taxed persons will not be taxed by two or more times, or in the worst case, not to be taxed at all.

Competition is a good way for states to keep their spending under control. National systems can use the fiscal instrument, as the tax competition which is a widely used practice in an integrated market, to increase their ability to attract businesses and capital" (Monti, 2010, point 3.5).

The economic relations between the states can be slowed down as a result of perceiving taxes as stimulating levers for the economy of the states but applying them, both in the country of origin and in the foreign country, if is not avoided the double taxation or if are not created the necessary methods to avoid the double taxation.

If the instruments necessary to avoid double taxation are not created, the taxation of the income obtained from "*productive, commercial, intermediation, financial activities, those from dividends due to participation in the capital of companies, from interest on the credits granted, royalties for the use or assignment of the use of patents, manufacturing processes, know-how, trademarks and other intellectual property rights, copyright for scientific, literary and art creations, as well as of other income categories, which takes place both in their country of origin, as well as in the country of residence of the beneficiaries of income, according to the tax legislation of each country*" (Mosteanu, 2003., p.14), can lead to the stagnation of the income producing activities.

In today's economy, double taxation is a common problem for citizens of the European Union. The 2011 Annual Report, the European Parliament's Committee on Petitions found that double taxation is a problem that people face; this represents an „*impediment to the freedom of movement*”.

Having a negative effect on capital investments is due to a double taxation on the single market which increases the global tax burden.

A favourable element for the state but also a disadvantageous element for the one who incurs the tax can be the incomes that are obtained in different states, and regardless of how they are obtained can be subject to double taxation. The double taxation can be the consequence of an obstacle to the development of economic relations, thus diminishing the income of the taxpayers.

6. Purpose of the conventions for avoiding double taxation

The request of the states to clarify the tax situation of taxpayers who carry out activities of a financial, industrial, commercial or other type of income generating activity, by finding common solutions in order to avoid double taxation is concluded with purpose of the conventions for avoiding double taxation.

The first convention for avoiding double taxation with the German state was on 01.01.1972, and the last convention was concluded by Romania with Saudi Arabia on 01.01.2013. A number of 8 conventions have been modified over these years: Austria, Belgium, Canada, Finland, Germany, Morocco, Netherlands, Pakistan, 82 conventions for avoiding double taxation were concluded by Romania so far.

Description of the purpose of each convention together with the persons and taxes covered by the convention, description of the methods of eliminating double taxation, special provisions regarding non-discrimination, definition of the terms used in the convention, amicable procedure, special provisions regarding the entry into force of the conventions, exchange of information, and, finally, the denunciation by the Contracting State by sending a Notification of Denunciation to the other Contracting State is the rule of application followed by the conventions.

The persons concerned are the resident persons of both or one Contracting States (*Model Convention on Income Taxes and Capital Taxes, art. 1*) according to the Model Convention on income and capital taxes.

The subject to taxation according to his residence, domicile, place of business management or any other criterion of a similar nature is defined as a resident person.

If a person, he or she will have a permanent establishment in this Contracting State in which they will carry out their activities, they will be considered a resident in one of the Contracting States and also a resident of both Contracting States.

7. Conclusions

As a conclusion double taxation is a phenomenon caused by the diversity of the fiscal systems of the states and also is a factor of influence on the international exchanges of goods, of the movements of people, goods but also of services.

Currently, there is no formal obligation for Member States to eliminate double taxation (bilateral conventions only require the parties to do everything possible in this regard).

The cases are presented by the affected company to the tax authorities concerned when the double taxation occurs and if the respective authorities cannot solve the problem satisfactorily, they try to reach a common agreement with the authorities of the Member State where the tax is perceived from the associated company.

The authorities present their case to an advisory committee, if no agreement is reached, which suggests a way to solve the problem.

European Union has already been dealing with the issue of double taxation. The Directive on parent companies and subsidiaries, the Directive on interest and royalties, the Arbitration Convention (AC), the achievements of the European Union (EU) Joint Transfer Pricing Forum (JTPF) (mainly the Code of Conduct for the effective implementation of AC) and the Recommendation on the procedures for reducing the tax withheld at source are relevant examples in this regard.

The real mechanism to combat the double taxation situations is not sufficient. All the relevant taxes from the single market perspective (for example, registration fees), are not covered by the conventions for avoiding double taxation and they do not provide for the complete elimination of double taxation and, above all, do not provide for a uniform solution for the Member States.

The existing tools do not always work effectively for avoiding double taxation. The Member States involved, more specifically, do not consistently apply and interpret the CDI provisions. The definition of some notions as royalties, corporate income, dividends and permanent establishment are mainly related to these contradictory practices. Taxpayers may be subject to double taxation, as a result, which is contrary to the CDI objectives.

The identified problems can be solved. That is why we propose the improvement of existing tools for situations of double taxation or by proposing new tools and solutions. Another proposal for finding the best solutions would be the amicable procedure by which the states agree with each other.

To analyse the problems related to double taxation and to take the most appropriate measures for the settlement mechanism to be efficient and fast in all areas of direct taxation.

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