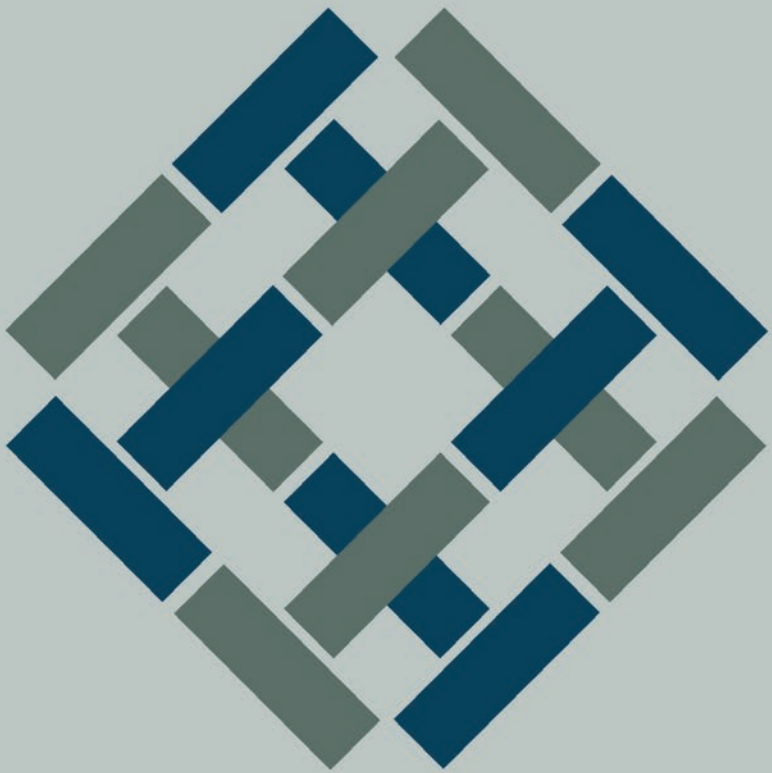
Kevin Holmes

International Tax Policy and Double Tax Treaties

An Introduction to Principles and Application

Second Revised Edition



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International Tax Policy and Double Tax Treaties

Why this book?
The world of international tax is constantly changing. Policies change, taxpayers modify their behaviour, laws change, new double tax agreements are concluded, existing ones are amended, and administrative practice is improved. International Tax Policy and Double Tax Treaties gives the reader an understanding of the concepts that underpin the dynamics of international tax law and double tax treaties.

This is an introductory book for an international readership, written primarily as a teaching text for generic international taxation courses. It draws on the tax law, double tax treaties, and experience of different countries to illustrate the application of general principles. The concepts addressed in the book are applicable to the international tax systems of developed, developing and transitional economies.

The book is an excellent learning tool for students and offers a useful refresher on fundamental precepts to experienced practitioners. The numerous case studies provide the reader with the opportunity to apply the principles and examples discussed to factual situations.

This new edition captures recent significant international tax policy and treaty developments, including modifications to the OECD and United Nations model double tax treaties and commentaries concerning permanent establishments and business profits, the taxation of technical services, electronic commerce issues, and international tax avoidance strategies adopted by high-profile multinational enterprises and intergovernmental responses to them.

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Preface to the Second Edition

The world of international tax is constantly changing. Policies change, laws change, new double tax agreements (DTAs) are concluded and existing ones amended, and administrative practice is improved. The period from 2007 (when the first edition of this book was published) until 2014 was no exception. This new edition addresses international tax policy and DTAs taking into account significant developments during that period.

The main changes incorporated in this edition include:
- modifications to the OECD and United Nations model DTAs and commentaries concerning permanent establishments and business profits;
- the taxation of technical services;
- electronic commerce issues;
- sales of shares in foreign special purpose vehicles which own assets in a particular country; and
- international tax avoidance strategies adopted by high-profile multinational enterprises and the inter-governmental responses to them, encompassing a more comprehensive exchange of information regime and other measures to prevent tax base erosion and profit shifting (BEPS).

The opportunity has also been taken to elucidate some explanations and discussion (such as the operation of country and income "baskets" in the calculation of limits on foreign tax credits, the way domestic laws embrace DTAs and the territorial scope of DTAs), and to correct some oversights in the first edition. The latest important international tax case law has been incorporated either in the text or in chapter revision questions.

Reader feedback on the first edition has been welcome and favourable. I wish to thank those readers who contributed their views, many of which I have adopted in this edition. Again, thanks to Elly Holmes for her tireless work in assembling background material and checking the text, and to IBFD for its provision of information, promotion of the book and confidence to publish this new edition.

Kevin Holmes
January 2014

Preface to the First Edition

This introductory book is written primarily to be used as a teaching text for generic international taxation courses. It has arisen from many years of practice and teaching international taxation to diverse audiences in a variety of countries. The students in those courses have ranged from undergraduates with no practical experience and experienced tax officials with little formal training in the field of international tax to highly qualified tax practitioners.

Regardless of your background or geographical location, international tax law and practice are underpinned by generic principles, which must at least be considered by all countries (if not necessarily applied, for reasons peculiar to a country's political economy at a particular time) when formulating the basis on which a country taxes cross-border transactions and economic events.

The purpose of this book, then, is to give you an understanding of the concepts that underlie international tax law and double tax treaties by providing an insight into how international tax policy, law and practice operate to ultimately impose tax on international business and investment.

The book is written at an introductory level, although it also serves as a refresher for hardened practitioners on the fundamental principles on which practice in the field is (or should be) based. At heart, this book is a primer on international tax policy and double taxation treaties. It is not intended to be a detailed reference text – it is a teaching and learning instrument.

The audience for this book is international. Therefore, it does not focus on the international tax regimes of a particular country or countries, although it does draw on the tax law, double tax treaties and experience of different countries to illustrate the application of general principles and propositions. The concepts addressed in the book are applicable to the international tax systems of developed, developing and transitional economies. To a large extent, the principles of international tax that are actually applied in a country are determined by the country's economic and social objectives. These will differ between countries depending on, amongst other things, the prevailing state of their development. Nevertheless, you, as a student of international tax in one country, need to understand the basis of the international tax policy of a trading partner country, or an investor or investee nation, at least to form a view about whether that country is taxing appropriately the income and wealth that arises from the two-country relationship. The same

comment applies in respect of the international tax policies embraced by your country. These considerations are particularly important in the context of negotiation and application of double tax treaties.

A sprinkling of review questions and case studies (usually based on real tax cases) has been inserted at the conclusion of each chapter to encourage you to think about how the material addressed in the chapter is applied to factual situations. The case studies are also intended to be a useful teaching tool, designed to facilitate academic mentors who wish to (and, indeed, are encouraged to) use them as examples when they adopt the case study teaching approach.

The structure of this book is to provide a narrative explanation of international tax policy and law, and the provisions of double tax treaties; particularly their fundamental design and application. International tax law and double tax treaties are fraught with interpretation difficulties and contradictions, which make their consistent application difficult. Where such problems arise, they must be confronted in the context of the underlying international tax policy objectives, which they are intended to achieve. The beginning of this book explains that policy framework.

Finally, but importantly, I wish to thank those who contributed directly and indirectly towards this publication. In particular, special thanks go to Elly Holmes for her extensive assistance in compiling information, collating much of the background case material and checking the text, and to IBFD for its provision of information and publication of the book. The active contributions of the array of participants in my international tax courses over the years are also gratefully acknowledged. Those contributions especially highlighted areas of greatest interest and debate, which have been examined more closely in this book. Of course, I am solely responsible for any errors, omissions or statements that are overly controversial.

Kevin Holmes
July 2007

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Sample chapter

Treaty Relief from Juridical Double Taxation

6.1. Introduction

We saw in chapter 2 that countries often provide their residents with relief from juridical double taxation unilaterally through their domestic income tax law. Either in addition, or if a country does not have double tax relief provisions in its domestic law, DTAs contain articles to achieve their objective of elimination of double taxation. Therefore, in the former case, prima facie a taxpayer has two avenues through which to obtain double tax relief in respect of income taxed in a country with which her country is a DTA partner. But as we saw in chapter 4, in the case of a conflict between the relief provisions in the domestic law and those in the DTA, the latter will normally prevail.

In this chapter, we will:
– distinguish between unilateral and DTA relief from double taxation;
– look at the role of article 23 of the OECD model DTA in eliminating juridical double taxation; and
– discuss tax sparing credit relief, and its advantages and disadvantages.

6.2. Unilateral and double tax treaty relief

Notwithstanding the obstacles that double taxation can present to the development of international economic relations, there is very limited international law constraining countries from imposing taxes on income derived outside of their borders. As a result, if double taxation is to be overcome, it must be dealt with domestically or unilaterally. Many countries have provisions in their domestic laws that are designed to unilaterally counter juridical double taxation. The tax credit method is the means adopted by most countries as a unilateral legislative tax relief mechanism. These measures, however, do not always fully combat double taxation.

Since it is obviously desirable to clarify and guarantee the fiscal position of taxpayers engaged in commercial, industrial or financial activities internationally, bilateral DTAs have also been developed over time between trading nations. These DTAs formally determine which country will tax an item or

taxpayer and/or whether exemptions of income or credits for tax paid will be granted in the other jurisdiction. In doing so, most DTAs explicitly give the source country the primary right to tax but require that country to limit its tax (rate of withholding tax) on certain income (e.g. dividends, interest, royalties) and, in the case of DTAs based on the OECD model, not to tax certain types of income at all (e.g. aircraft, shipping). In this sense, the OECD model DTA severely limits the taxing powers of source jurisdictions.

Double tax agreements, therefore, offer taxpayers relief from juridical double taxation. Although such relief is often already provided for in a country's domestic tax legislation, relief via a double tax treaty may be more generous than that in the domestic law. For example, the domestic law may allow for limited relief by way of a tax deduction in the taxpayer's country of residence for tax paid in a foreign jurisdiction, whereas a DTA which follows the OECD model DTA will allow for either a full exemption or a tax credit, both of which confer a greater tax benefit on the taxpayer than a deduction from assessable income.

Relief entrenched in a DTA also restricts a country's ability to amend unilaterally the double tax relief provisions in its domestic law to the detriment of taxpayers who are covered by the provision of a DTA. This could come about where, for example, Singapore (which offers an exemption in its domestic law for foreign source income derived by its resident individuals) enters into a DTA with Samoa, and the DTA includes the same foreign income exemption. If Singapore subsequently terminates the exemption by repealing its domestic law, residents of Singapore will continue to benefit from the exemption with respect to income derived from Samoa under the DTA exemption until the DTA provision is changed or the DTA is ended.

6.3. Article 23 of the OECD model double tax treaty

Article 23 of the OECD model DTA ("Methods for elimination of double taxation") offers a choice of the exemption method (article 23A) or the credit method (article 23B) of relief from double taxation.

6.3.1. Article 23A – Exemption method

Where the exemption method is chosen, under article 23A(1) a taxpayer's country of residence prima facie must exempt income or capital from tax if that income or capital *may be* taxed by the source state "in accordance

with the provisions of [the] Convention", whether or not the source state actually exercises its right to tax the item of income or capital. Note that article 8(3) (Shipping, inland waterways transport and air transport),[42] Article 13(3) (Capital gains),[43] articles 19(1)(a) and 19(2)(a) (Government service)[44] and article 22(3) (Capital)[45] state that income or capital arising under those articles "shall be taxable only" in the source state. Therefore, such income or capital is automatically exempt from tax in the country of residence of the taxpayer.

Country R is not required to apply the exemption if Country S considers that the provisions of the DTA preclude it from taxing an item of income or capital which it would otherwise have taxed. In that case, the OECD commentary provides that Country R should, for the purposes of applying article 23A(1), consider that the item of income or capital may not be taxed in Country S, even though Country R might have applied the DTA differently so as to tax that income if it were Country S. In these circumstances, Country R is not required by article 23A(1) to exempt the item of income or capital. This result is consistent with the elimination of double non-taxation.

Example 6.1.

Suppose that a business is carried on through a fixed place in Country S by a partnership, which is established in Country S, and a partner, who is resident in Country R, alienates her interest in that partnership. Assume that Country S treats the partnership as a company whereas Country R treats it as fiscally transparent, and that Country R applies the exemption method of double tax relief. Because it treats the partnership as a corporate entity, Country S considers that the alienation of the interest in the partnership is akin to the alienation of a share in a company, which it cannot tax by reason of article 13(5).[46] However, Country R considers that the alienation of the interest in the partnership should have been taxable by Country S as an alienation by the partner of the underlying assets of the business carried on by the partnership, to which article 13(2) would have applied.[47] In determining whether to exempt the income under article 23A(1), Country R can take the view that since Country S considers that the DTA bars it from taxing the capital gain, Country S may *not* tax it in accordance with the provisions of the DTA, and therefore Country R is under no obligation to exempt the income.[48]

42. See section 10.13.
43. See chapter 16.
44. See section 17.6.
45. See section 18.5.
46. See chapter 16.
47. OECD commentary on Arts. 23A and 23B, Para 32.7.
48. OECD commentary on Arts. 23A and 23B, Para 32.6.

Furthermore, exemption by Country R does not apply where Country S applies a provision of the DTA to exempt the income or capital from tax (or where the income is dividends or interest subject to concessional tax rates in Country S under article 10(2) or 11(2)):[49] article 23A(4). Again, this qualification prevents double non-taxation of the same income. This is also relevant when there is a disagreement between Country R and Country S about the facts of a case or about the interpretation of a provision of the DTA between them. For instance, article 23A(4) would apply when Country S interprets the facts of a case or the provisions of the DTA such that an item of income or capital falls under a provision of the DTA that eliminates its right to tax that item or limits the tax that it can impose while Country R adopts a different interpretation of the facts or the provisions of the DTA and considers that the item may be taxed in Country S in accordance with the DTA, which otherwise would lead to an obligation on Country R to give an exemption under article 23A(1).

Article 23A(4) applies to the extent that Country S has applied the provisions of the DTA to exempt an item of income or capital from tax or has applied the provisions of article 10(2) or 11(2) to an item of income. Therefore, article 23A(4) does not apply where Country S considers that it *may* tax an item of income or capital in accordance with the provisions of the DTA but where no tax is actually payable on such income or capital under Country S' domestic law. In such a case, Country R *must* exempt that item of income under article 23A(1) because the exemption in Country S does not result from "the application of [the] provisions of [the] Convention" but, rather, from the domestic law of Country S.

Where certain items of income (viz. dividends and interest) are subject to only limited tax in Country S – because of application of articles 10(2) and 11(2) of the relevant DTA, which also give Country R the right to tax that income – use by Country R of the exemption method under article 23A contradicts Country R's entitlement to tax under articles 10 and 11 (by, in effect, requiring Country R to give up its right to tax under the latter sections). Therefore, article 23A(2) provides for the application of the ordinary credit method by Country R to facilitate relief from double taxation on that income, rather than solely using the exemption method.

Article 23A(3) allows Country R to adopt the exemption with progression method of double tax relief.[50]

49. See chapters 12 and 13.
50. See section 2.4.1.2.

6.3.2. Article 23B – Credit method

Article 23B(1) provides for relief from double taxation by way of the *ordinary* credit method. (The *ordinary* credit method also applies for the purposes of article 23A(2)). Application of article 23B by Country R is again dependent upon the ability of Country S to be *able to* tax the income or capital in question "in accordance with the provisions of [the] Convention" between Country R and Country S.

Article 23B(1) allows a credit for income tax paid in Country S only against income tax payable in Country R and, quite separately, a credit for capital tax paid in Country S only against capital tax payable in Country R.

Practical difficulties arise with the foreign tax credit method when tax payable in Country S is not calculated in respect of the income year in which it is levied, but on the basis of a preceding year's income or on the basis of the average income earned over a number of preceding years, and with foreign exchange rate movements between the date of payment of the tax in Country S and the date on which that tax and the income to which it relates is converted for the purposes of inclusion in the taxpayer's assessable income in Country R. Furthermore, income on which tax may be paid in Country S may reduce a taxpayer's net loss position in Country R without any relief for the tax paid in Country S.

Example 6.2.

Assume that a taxpayer resident in Country R is in the following position:

Foreign source income (Country S)	1,000
Domestic source income (loss) (Country R)	(5,000)
Worldwide income (loss)	(4,000)
Foreign tax payable on foreign source income (20% × 1,000)	200
Domestic tax payable on worldwide income	0
Less: ordinary credit for foreign tax paid on foreign source income	(0)
Net tax payable in Country R	0
Total tax payable	200

Overall, the taxpayer pays tax of 200, notwithstanding that it is in a net loss position of 4,000. In effect, the taxpayer pays tax when it derives no net income. It correctly pays tax to Country S where, taken in isolation, it does derive income. However, the Revenue of Country R has the benefit of applying the income sourced in Country S to reduce the amount of the taxpayer's loss carried forward (from 5,000 to 4,000) without having to yield tax revenue by giving any credit for the 200 paid by its resident taxpayer to Country S.

Similar inequities arise in other circumstances because the ordinary tax credit allowed by Country R is typically based on *net* income, being gross income less allowable deductions (in Country R).

Example 6.3.

Suppose that a taxpayer in Country R borrows 1,000 at an interest rate of 10% p.a. and on-lends that sum to a borrower in Country S at a rate of 12% p.a. The taxpayer's net income from these transactions is:

Gross interest income (1,000 × 12%)	120
Less: interest expense (1,000 × 10%)	100
Net income	20

Assume that Country S imposes a final non-resident withholding tax of 10% on gross interest payments made by its resident borrower to non-resident lenders, and Country R imposes tax at the rate of 15% on the worldwide (net) income of its residents. The tax position of the lender, resident of Country R, is:

Foreign tax payable on foreign source income (10% × 120)	12
Domestic tax payable on worldwide income (15% × 20)	3
Less: ordinary credit for foreign tax paid on foreign source income	(3)
Net tax payable in Country R	0
Total tax payable	12

Here, the taxpayer pays tax at an effective rate of 60% because Country S' tax is based on gross income and Country R's tax is based on net income. There is no reprieve, notwithstanding that the taxpayer's true income is the net amount and Country R's tax rate is only 15% of that net amount. In the extreme, if the taxpayer had on-lent the 1,000 at no margin, it would have been taxed 10 (at Country S' 10% rate on gross interest income of 100) when it derived no (net) income at all. Such problems can be militated against by Country R allowing its residents to carry forward or to carry back excess, unused foreign tax credits.[51]

Article 23B(2) permits Country R to take into account the amount of income or capital exempted from tax in Country R under a provision of its DTA with Country S (because, for example, the DTA provides that the income or capital "shall be taxed only" in Country S) to determine the amount of tax payable on the rest of the income or capital, which is taxable in Country R. In essence, therefore, article 23B(2) preserves progression in Country R's income tax scale (analogous to exemption with progression, discussed in section 2.4.1.2.).

51. Although in the latter example, the problem arises from Country S' imposition of tax on gross, rather than net, income.

6.4. Tax sparing credit relief

Some DTAs provide for foreign tax credit relief by way of "tax sparing". Tax sparing arises where a source country offers tax incentives to (foreign) investors, which result in reduced or no tax payable in the country of source of the investor's income, compared with the amount of tax that would otherwise have been payable in Country S. Such tax breaks are of no benefit to foreign investors if their country of residence imposes tax on their worldwide income and offers relief from double taxation using one of the tax credit methods. Certainly, no double taxation arises since the investor's foreign source income is either only taxed in Country R or taxed at a reduced rate in Country S, for which tax Country R gives a credit. However, such income, ultimately being effectively taxed at Country R's tax rate, cancels the effect of the tax incentive offered by Country S. In fact, the benefit of Country S' tax incentive passes from the foreign investor (for which it is intended) to the government of Country R (for which it is not intended).

Example 6.4.

A resident of the United Kingdom earns income of 1,000 from China (which is its only income for an income year). For simplicity, assume that the tax rate in the United Kingdom is 30% and the tax rate in China is 30%. The taxpayer's tax position in each country is:

China	
Income sourced in China	1,000
Tax payable in China	300

United Kingdom	
Worldwide income	1,000
Tax on worldwide income (30% × 1,000)	300
Less: foreign tax credit	(300)
Tax payable in the United Kingdom	0
Total tax payable (all to China)	300

Now suppose that the investor had invested in a project that qualified for China's former 10-year tax holiday incentive regime. The taxpayer's respective tax positions become:

China	
Income sourced in China	1,000
Tax payable in China	0

United Kingdom	
Worldwide income	1,000
Tax on worldwide income (30% × 1,000)	300
Less: foreign tax credit	(0)
Tax payable in the United Kingdom	300
Total tax payable (now all to the United Kingdom)	300

Therefore, under the foreign tax credit system, notwithstanding the tax holiday offered by China, the taxpayer pays the same amount of tax in total. China's tax holiday regime has meant that China gave up the 300 tax not to the investor, but to the UK Revenue!

To overcome this consequence, some DTAs specifically provide for tax sparing credits. For example, article 23(6) of the China–United Arab Emirates DTA (1993) provides that:

> For the purposes of the credit referred to in paragraph 3 [the ordinary tax credit allowed by the United Arab Emirates], Chinese tax payable shall be deemed to include the amount of Chinese tax which would have been paid if the Chinese tax had not been exempted, reduced or refunded in accordance with:
>
> a) The provisions of Articles 7, 8, 9 and 10 of the Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises …
>
> c) The provisions of any reduction in, exemption from or refund of tax designed to promote economic development in China which may be introduced under the laws of China.

Example 6.5.

Taking the information in Example 6.4., now assume that such a tax sparing provision existed in the China–United Kingdom DTA. The benefit of the tax holiday offered by China would now pass to the investor taxpayer, rather than to the UK Revenue, as the new tax position demonstrates:

China	
Income sourced in China	1,000
Tax payable in China	0

United Kingdom	
Worldwide income	1,000
Tax on worldwide income (30% × 1,000)	300
Less: foreign tax credit (tax otherwise payable in China in the absence of the 10-year holiday: 30% × 1,000)	(300)
Net tax payable in the United Kingdom	0
Total tax payable	0

Thus, the benefit of the tax holiday is preserved for the taxpayer. Presumably, it invested in the China project (at least in part) because it would not have to pay tax on income derived from it. The tax sparing credit, if allowed by the United Kingdom, would preserve that position of the taxpayer.

Similar tax sparing relief can also be offered by capital exporting countries by simply deeming that specified amounts of tax are paid in the country of source and allowing a tax credit for those deemed amounts, whether or not they are actually paid. Again, the China–United Arab Emirates DTA contains such a provision in respect of passive investment income (article 23(5)):

> For the purposes of the credit referred to in paragraph 3 [the ordinary tax credit allowed by the United Arab Emirates], the amount of Chinese tax imposed on items of income under Articles 10, 11 and 12 shall be deemed to have been paid at:
> a) twenty percent (20%) of the gross amount of interest;
> b) twenty percent (20%) of the gross amount of royalties.

Tax sparing credits are not provided for in the OECD model DTA or (perhaps somewhat uncharacteristically) in the UN model DTA. The United States vehemently opposes tax sparing credits and, therefore, they do not appear in the US model DTA or in any of its bilateral DTAs. On the other hand, some developing countries do not enter into DTAs with developed countries unless the latter offer tax sparing credits. Obviously, there is no need for tax sparing credits if the investor's country of residence uses the exemption method of double tax relief.

The reasons that tax sparing provisions have been excluded from the model DTAs and most bilateral DTAs between developed and developing countries are:[52]

(1) Experience has shown that tax sparing is very vulnerable to taxpayer abuse, which can be very costly in terms of lost revenue to both the country of residence and the country of source. This kind of abuse is difficult to detect. In addition, even where it is detected, it is difficult for the country of residence to react quickly against it. The process of removing or modifying existing tax sparing provisions to prevent such abuses is often slow and cumbersome.

(2) Tax sparing is not necessarily an effective tool to promote economic development. A reduction or elimination of the benefit of the tax incentive by the country of residence will, in most cases, only occur to the extent that profits are repatriated. By promoting the repatriation of profits, tax sparing may therefore provide an inherent incentive to foreign investors to engage in short-term investment projects and a disincentive to operate in the source country on a long-term basis. Also, foreign tax credit systems are usually designed in a way that allows a foreign investor, in computing its foreign tax credit, to offset to some extent the reduction of taxes resulting from a particular tax incentive with the higher taxes paid in that or another country so that, ultimately, no additional taxes are levied by the country of residence as a result of the tax incentive, i.e. a "basket" foreign tax credit system (see section 2.4.2.3.) is not applied.

(3) The accelerating integration of national economies has made many segments of the national tax bases increasingly geographically mobile. These developments have induced some countries to adopt tax regimes that have as their primary purpose the erosion of the tax bases of other countries. These types of tax incentives are specifically tailored to target highly mobile financial and other services that are particularly sensitive to tax differentials. The potentially harmful effects of such regimes may be aggravated by the existence of ill-designed tax sparing provisions in DTAs. This is particularly so where a country adopts a tax regime subsequent to the conclusion of its DTAs and tailors this regime so as to ensure that it is covered by the scope of the existing tax sparing provision.

52. OECD Committee on Fiscal Affairs, "Tax Sparing – A Reconsideration", *OECD Model Tax Convention*, Paris: OECD, 1998, Vol. II, loose-leaf version, R(14)-1.

The OECD Committee of Fiscal Affairs concluded that OECD members should not necessarily refrain from adopting tax sparing provisions; however, tax sparing should be considered only in regard to countries the economic level of which is considerably below that of OECD member states and to minimize the potential for abuse of such provisions by ensuring that they apply exclusively to genuine investments aimed at developing the domestic infrastructure of the source state. A narrow provision applying to real investment would also discourage harmful tax competition for geographically mobile activities.

6.5. Conclusion

To achieve the objective of elimination of juridical double taxation, we have examined the various forms of relief from such double taxation, the rationale behind them and their unilateral adoption in countries' domestic tax laws and in DTAs, the latter exemplified by Art 23 of the OECD model DTA. This chapter also explained the concept of, and the resistance towards, tax sparing credits.

The key concepts discussed in this chapter were:
– unilateral relief;
– DTA relief;
– exemption method;
– credit method; and
– tax sparing.

Review questions and case studies

1. Why does a country offer double tax relief via its DTAs when it already unilaterally provides relief from juridical double taxation in its domestic legislation?

2. Why does article 23B of the OECD model DTA produce an incongruous outcome if a taxpayer that is a resident of Country R derives income from Country S, but is in an overall tax loss position in Country R?

3. Explain the concept of tax sparing. Why are many developed countries reluctant to include tax sparing provisions in their DTAs?

4. In November 2013, the Philippines Bureau of Internal Revenue informed the internationally renowned boxer, Manny Pacquiao, to pay outstanding taxes of PHP 2.2 billion (approximately USD 50 million) in respect of his successful bouts in the United States in 2008 and 2009. Mr Pacquiao argues that he paid his taxes in the US and therefore does not need to do so in the Philippines because the two countries have a DTA.

   Is Mr Pacquiao correct?

5. Theo, a resident of Reynes, receives income from sources in the Mercia, being military pension payments and Mercia social security payments, both of which he is entitled to following his father's death on an official assignment while he was in the Mercia air and naval forces.

   Under Reynes domestic law, these pension payments would not be taxable if they were income sourced in Reynes. On the grounds of this article, Theo takes the position that the income should not be taxable in Reynes, nor should it be taken into account in calculating his effective tax rate under the exemption with progression method. (see section 2.4.1.2.)

   The Reynes tax authorities consider that the pension payments are not taxable in Reynes. However, they argue that the Mercia pensions

should be taken into account in order to calculate the Reynes effective tax rate under the exemption with progression method on the basis of the Mercia–Reynes DTA, which states that:

> Reynes tax may be computed on income chargeable in Reynes by virtue of this Convention at the rate appropriate to the total of the income chargeable in accordance with Reynes law.

Should the Mercia military pension and social security payments be taken into account under the exemption with progression method of article 23A (Elimination of double taxation) of the Mercia–Reynes DTA?

6. John Smith, a professional sportsman and a resident of the United Kingdom, entered into a contract to provide his services to a sports team in France. The contract states that the sums to be paid to John are to be paid "net of tax", but the contract does not modify his liability under French law to account to the French tax authorities for French income tax on his income. He worked in France during the calendar years 2011 to 2013. He left the United Kingdom in the middle of 2011, but as the period that he spent in France was less than a complete UK tax year and he often returned to the United Kingdom, he continued to be a resident of the United Kingdom for UK tax purposes throughout the whole of the 2011/12, 2012/13 and 2013/14 tax years. As he had a home in France and carried on his professional activity there, he was also a resident of France for French tax purposes throughout the period.

   John was assessed French income tax for the 2011 year and he paid the amount owing to the French tax authorities. He received credit in respect of that sum against his UK tax liability under the France–United Kingdom DTA (2008). For the 2012 and 2013 years he did not file tax returns in France, nor did he receive any tax assessments or pay tax. He was assessed income tax in the United Kingdom on his French earnings for the tax years 2012/13 and 2013/14 and claims that he is entitled to credit under the France–United Kingdom DTA in respect of his French tax liability even though tax has not been paid.

   Should John be entitled to a foreign tax credit?

7. Nils, an engineer and a resident of Denmark, has lived away from his wife and two children since mid-2014. They continued to live in the Netherlands in a house owned by Nils. For the 2015 tax year, Nils claimed deductions in his Danish tax return for support payments equal to DKR 91,000 and DKR 25,000 for mortgage interest and property taxes for his house in the Netherlands.

   The local tax authorities approved only the deduction for the mortgage interest and property taxes and disallowed Nils' claim for support payments on the grounds that support payments to a family living apart may be deducted only if they have been fixed or approved by an official authority. This was not done until December 2016. Nils argues that the tax authorities' position conflicts with the Denmark–Netherlands DTA (1996), since his wife is subject to tax in the Netherlands on the support payments. Hence, denial of the deduction results in double taxation.

   Are the support payments deductible in Denmark under the Denmark–Netherlands DTA to avoid double taxation?

Notes

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