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DOUBLE TAXATION – METHODS OF AVOIDING IT AT NATIONAL AND INTERNATIONAL LEVEL

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Abstract

Double taxation is the levy of tax by two or more jurisdictions on the same declared income asset or financial transaction.

Depending on the juridical aspects related to the legislator's will, double taxation can be deliberated or unintentional. It is also based on various criteria of appearance, such as residency criterion, criterion of nationality and source of income. There exist different methods to avoid double taxation at national and international level, by respecting both domestic laws and conventions signed between the involved parties.

Key words: *double taxation, residency criterion, criterion of nationality, criterion for source of income, methods to avoid*

JEL Classification: M410

I. Content

Double taxation is a permanent global issue that generates the increase of fiscal pressure and enhances the appearance of tax evasion, hampers the development of economic activity, reduces investing attractiveness and, hence, minimizes the financial resources attracted from entities to the state budget.

Under these circumstances, in order to avoid double taxation for both natural and legal persons, the need for adjusting the local tax system is a prerequisite.

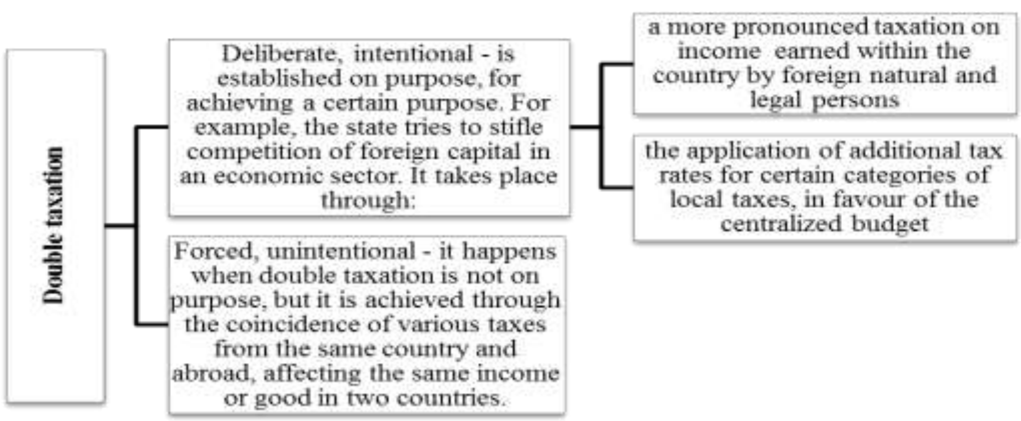
Double Taxation: Notion and Essence. Double taxation is the levy of tax for a taxable object, for the same period of time by two different fiscal authorities from different countries.

The causes of double taxation are:

- The situations in which natural and legal persons that come from one country, earn their income on the territory of other countries;
- The situations, in which the tax jurisdiction from each of the countries claims the taxes totally or partially and thus, generate the existence of more complementary or competing tax systems.

Forms of Double Taxation. Taking into account the juridical aspects that depend on the tax authority, the forms of double taxation that can occur in a country are represented in Figure 1.

Figure no. 1 - Forms of double taxation



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Double Taxation Criteria. In the international tax practice there exist various criteria that underlie the occurrence of double taxation, such as:

a) *Residency criterion* (tax residence) – the taxation of income or wealth is done by the tax authority from the country to which the resident belongs, regardless if the income or wealth that is taxed has been obtained on the territory of the country or

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abroad. This criterion is applied in the UK, Switzerland, the Republic of Moldova, etc.

b) *Criterion of nationality* – the country requires the residents who earn revenues or own wealth from/in that country to pay taxes, whether they live or not in their own country.

c) Source of income criterion – taxation is performed by the tax authorities from the country in which revenues or wealth were earned, regardless the residence or nationality of the income recipients. This criterion is applied in countries as: the UK, Japan, Ireland, etc.

The Republic of Moldova applies the criterion of nationality for legal persons and the residency and source of income criteria for natural persons. Additionally, priority is offered to tax authorities of the countries in which revenues were earned. Usually, the authorities from the residence state of the tax payer are responsible for the reduction of the tax burden that aims to avoid double taxation.

The above mentioned criteria are differently applied by each country, depending on:

- The interest for the stimulation of certain activities that generate taxable incomes;
- The economy's development level, its structure and peculiarities;
- The type and framework of agreements with different states, including the membership to different regional organizations;
- The recommendations of global organizations.

In order to explain the above-mentioned theory, the following study cases are illustrated:

Case 1: A British citizen who lives in the United Kingdom works as a free lancer. This year, he will be working for at least 3 months is Austria, as a ski instructor. In which country does he have to pay the taxes?

Answer: If the employer has its headquarter in Austria, the income will be taxed there, regardless for how long the UK citizen will stay in Austria. If he stays in Austria for less than 6 months, he will keep his tax domicile in the United Kingdom. The British authorities can tax all the revenues that were earned at global level, including the ones from Austria. Normally, the taxes paid in Austria can be deducted from the taxes that have to be paid in the United Kingdom.

Case 2: A Finnish retired man lives in Italy. For the last 40 years he has been contributing to a Finnish pension fund. Do the Italian tax authorities have the right to tax the pension he receives?

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Answer: According to the standard agreements regarding double taxation, the private sector pensions are taxed in the country of residence. In this case, in Italy, the tax rate for pensions is 24.1%. However, dividends can be taxed in both countries. Respectively, the Italian tax authorities have to deduct the taxes paid in Finland from the overall sum of the taxes that are to be paid in Italy.

Case 3: A Polish citizen lives and works in Germany. He has received a request from the Polish tax office to declare his foreign income. He has already paid his taxes in Germany. Can two countries request tax declarations from him for the same period and for the same income?

Answer: YES, member states are free to apply tax rules and request tax declarations as they choose – as long as they do not apply these procedures in a discriminatory way. It is unusual, but not unheard of, for countries to require their nationals who are non-resident to declare their income. Moreover, the fact that this citizen lives and works in one country may not necessarily mean that he is resident there under the terms of the tax treaty between that country and his home country/country of citizenship.

In the same context, is necessary to highlight the fact that in case of income source criterion, the taxation is done by the tax authorities from the country on whose territory were achieved revenues or is located the wealth, leaving aside the residence or nationality of income beneficiaries.

Respectively, if in the country "A" the taxation is done according to the residency criterion, but in country "B" – according to the income source criteria, then the natural or legal person from country "A" that achieves revenues in country "B", will have to pay taxes on his income, both in the country of residence and in the country of income origin.

Let's suppose that in Romania the taxation is based on the residency criterion (center of interest is in Romania, or the natural person lives there for more than 183 days during 12 consecutive months), and in Belgium – on the source of income criterion. Then, if a person from Romania works and achieves revenues in Belgium, he will have to pay taxes on his revenues, both in the country of residence (Romania) and in the country of income origin (Belgium).

However, due to the Income Tax Treaty Belgium – Romania for the avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to taxes on Income and Capital, double taxation disappears. Thus, the employee is taxed only by the country in which he gains revenues.

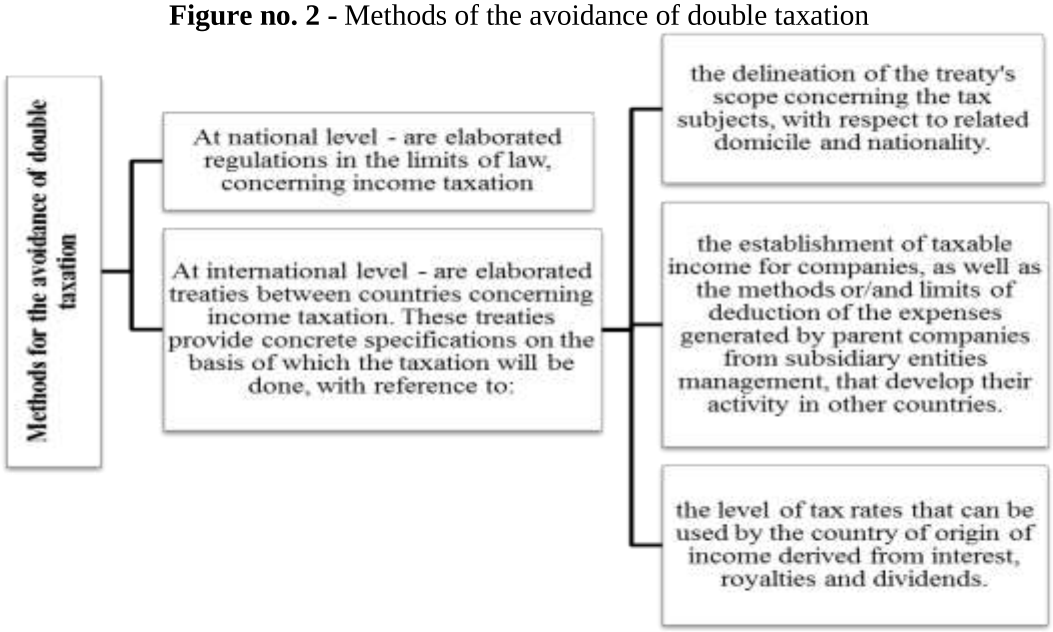
The preferences for these criteria vary depending on the parties involved in the taxation process.

Consequently, the *tax payer*, which is a natural or legal person, will prefer the *residency criterion*, as:

- The income and capital taxation process is simpler, because the payer has a relationship with the tax authorities from the country of residence;
- It takes into account the financial situation of the tax payer and offers some facilities (which, firstly, might target the revenues, originated from foreign sources), stimulating in this way his economic activity.

On the other hand, the *State* will prefer the *source of income criterion*, because it allows to exclude the possibility of achieving revenues in the respective country, without taxing it. Nowadays, there are methods for the avoidance of double taxation, as shown in Figure 2.

Figure no. 2 - Methods of the avoidance of double taxation



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The issue of double taxation elimination is treated from three points of view:

1. From the point of view of country-source (on the territory of which are located income sources) – determine the country from which comes the taxable income whether to reduce or to eliminate taxes.
2. From the point of view of the 2 member countries of the treaty, through a specific article called "Amicable procedure". Thus, the tax authorities of those two countries consult each other for solving the issue of different perceptions and applications of the tax treaty.
3. From the point of view of tax payer's residency – in case the residence country is the one that offers tax facilities to the tax payer for the taxes paid in the country where he gained income, the facilities consist, actually, in reducing the taxes owed to the residence country, either from the taxable amount obtained in these two countries, either from the tax payable in these countries.

II. Conclusions

Considering the increasing phenomenon of population migration, the diversity of tax liabilities is aligning with the process. Is necessary, therefore, that both natural and juridical persons, to understand which of the taxation criteria (residency, nationality or income source) are imposed by the host country's tax jurisdictions. Thus, in the sight of double taxation legal avoidance, is recommended a good knowledge and practical application not only of the domestic legislation, but also of the international treaties.

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